REPORT NO. AU 25-01

NOVEMBER 4, 2024

PERFORMANCE AUDIT OF THE LEGAL SERVICES CORPORATION'S OVERSIGHT OF ITS INTEREST IN GRANTEES' REAL PROPERTY

FINAL AUDIT REPORT

OFFICE OF INSPECTOR GENERAL

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LEGAL SERVICES CORPORATION

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Legal Services Corporation
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MEMORANDUM

TO: Ronald S. Flagg
President, Legal Services Corporation

FROM: Thomas E. Yatsco,
Inspector General

DATE: November 4, 2024

SUBJECT: Performance Audit of LSC's Oversight of its Interest in Grantees' Real Property

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Enclosed is the final report of the Performance Audit of the Legal Services Corporation's (LSC) Oversight of its Interest in Grantees' Real Property. The Office of Inspector General (OIG) contracted with the independent public accounting firm, Sikich CPA LLC (Sikich) to conduct the audit. The contract required Sikich's audit work to be conducted in accordance with Generally Accepted Government Auditing Standards. Appendix A of the report includes LSC's comments to the draft report in its entirety.

Sikich is responsible for the attached audit report and the conclusions expressed in this report. We do not express any opinion on the conclusions presented in the audit report. To fulfill our responsibilities, we:

- Reviewed the approach to and planning of the audit;
- Evaluated the qualifications and independence of the auditors;
- Monitored the progress of the audit at key points;
- Coordinated periodic meetings, as necessary;
- Reviewed the draft and final audit reports; and
- Coordinated the issuance of the audit report.

Sikich made eleven recommendations and one suggestion for consideration in the report. Sikich's evaluation of LSC management's comments and responses to the recommendations and suggestion for consideration can be found on pages 16-18. Appendix D of the report includes the OIG's evaluation of LSC's responses to the recommendations and suggestion for consideration.

The OIG considers LSC's proposed actions to Recommendations 1, 2, 3, 4, 5, 8, 9, 10, and 11 as responsive; however, these nine recommendations will remain open until they are completely addressed, and the OIG is provided with supporting documentation.

The OIG considers LSC's comments to Recommendations 6 and 7 as partially responsive. These two recommendations will remain open until LSC provides the OIG with a corrective action plan that specifically addresses the recommendations and documentation that the corrective action has been implemented.

On October 9, 2024, LSC management reported to the OIG that the Office of Compliance and Enforcement (OCE) completed their Policies and Procedures Manual on September 23, 2024. OCE provided the manual to the OIG and indicated that the policies and procedures will be implemented as of January 1, 2025. All findings and recommendations made within this report by Sikich were made prior to the completion of the manual.

To close out the 11 recommendations, please send a response, along with the supporting documentation detailed in Appendix D, to Roxanne Caruso, Assistant Inspector General for Audit. We thank you and your staff for your cooperation and expect to receive your submission by May 5, 2025.

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

Enclosure

Cc: Lynn Jennings
Vice President for Grants Management

Lora Rath
Director, Office of Compliance and Enforcement

LSC Board of Directors

Executive Summary

Performance Audit of the Legal Services Corporation's Oversight of its Interest in Grantees' Real Property

The Office of Inspector General (OIG) contracted with Sikich CPA LLC (Sikich) to conduct a Performance Audit of the Legal Services Corporation's (LSC) Oversight of its Interest in Grantees' Real Property. LSC maintains an interest in real property that grantees purchase or improve (in whole or in part) with LSC funds.

Objective

The audit objectives were to assess the effectiveness and efficiency of LSC's oversight, including fiscal accountability, compliance with LSC regulations and guidance, as well as LSC's compliance with accounting and financial reporting standards. As it relates to real property purchased with LSC funds, the audit assessed the prior approval process, use of funds, policies and procedures, completeness and accuracy of recordkeeping, use of property, maintenance, insurance, accounting and reporting, disposal and use of income derived from sale of the real property.

AUDIT RESULTS

Sikich found that LSC does not currently have:

- sufficient policies, processes, and/or tracking mechanisms in place to effectively oversee its interest in grantees' real property, or
- accurate records to support its real property interests.

Sikich also found issues with grantees' financial reporting of LSC-funded real property and that LSC and its grantees are not consistently maintaining documentation necessary to support that LSC-funded real property interests were:

- appropriately approved,
- appropriately disposed of, and/or
- assessed annually in accordance with LSC regulations.

Sikich did not identify any issues with LSC's compliance with applicable accounting and financial reporting standards, or with grantees' use of income derived from the sale of real property.

RECOMMENDATIONS

Sikich included two findings with 11 recommendations and one suggestion for consideration. These recommendations are intended to strengthen LSC's processes and procedures for approving, tracking, and maintaining accurate records of its real property interests, as well as enhance its review of related party rent expenses.

MANAGEMENT RESPONSE

LSC Management agreed with eight recommendations and partially agreed with three recommendations and the one suggestion for consideration. LSC Management provided proposed actions to all recommendations and the one suggestion for consideration. The OIG evaluated its responses and determined that all recommendations remain open until the OIG is provided additional supporting documentation (see Appendix D). LSC Management's response is included in its entirety in Appendix A.

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Mr. Tom Yatsco
Inspector General
Office of Inspector General
Legal Services Corporation
1825 I (Eye) St., NW
Suite 800
Washington, DC 20006

October 18, 2024

Dear Mr. Yatsco,

Sikich CPA LLC (herein referred to as "we") conducted a performance audit to assess the effectiveness and efficiency of the Legal Services Corporation's (LSC's) oversight of its interest in grantees' real property, including fiscal accountability, compliance with LSC regulations and guidance, and LSC's compliance with accounting and financial reporting standards. We performed the audit in accordance with our Statement of Work for Task Order 2, dated March 22, 2023, and modified September 18, 2023. Our report presents the results of the audit and includes recommendations to help improve LSC's oversight of its interest in its grantees' real property.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards (GAGAS) issued by the Comptroller General of the United States (2018 Revision, as amended). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

This report is intended solely for the use of the LSC Office of Inspector General (OIG) and LSC management and is not intended to be, and should not be, relied upon by anyone other than these specified parties.

We appreciate the opportunity to have conducted this audit. Should you have any questions or need further assistance, please contact us at (703) 836-1350.

Sincerely,

Sikich CPA LLC

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BACKGROUND

The Legal Services Corporation (LSC) operates as an independent 501(c)(3) nonprofit corporation that promotes equal access to justice and provides grants for civil legal assistance to low-income Americans. LSC receives 99 percent of its funding through federal government appropriations and distributes more than 90 percent of its funding to 131 independent nonprofit legal aid programs (grantees) with more than 800 offices.

The LSC Office of Inspector General (OIG) has two principal missions: 1) to assist management in identifying ways to promote efficiency and effectiveness in the activities and operations of LSC and its grantees, and 2) to prevent and detect fraud and abuse. The OIG's primary tool for achieving these missions is fact-finding through financial, performance, and other types of audits, evaluations, and reviews, as well as investigations into allegations of wrongdoing. LSC OIG may also hire contractors to provide these services and engaged Sikich CPA LLC (formerly Cotton & Company Assurance and Advisory, LLC; herein referred to as "we") to conduct a performance audit of LSC's oversight of its interest in Basic Field grantees' real property.

LSC maintains an interest in real property that grantees purchase or improve (in whole or in part) with LSC funds through the execution of property interest agreements. LSC regulations, specifically 45 Code of Federal Regulations (C.F.R.) Part 1631, require grantees to obtain prior approval for LSC-funded real property purchases and dispositions, obtain insurance for and properly maintain LSC-funded real property, and maintain an accounting of LSC funds related to the real property acquisition and maintenance.[1] The LSC Office of Compliance and Enforcement (OCE) has primary responsibility for monitoring grantee compliance with these regulations and does so by receiving and processing grantees' requests for prior approvals, overseeing grantees' LSC-funded property transactions, and maintaining all relevant property records.

LSC OCE's oversight of LSC's interest in grantees' real property is important to ensure its interest is protected and to ensure grantees are complying with relevant regulatory requirements. Specifically, because grantees must record and utilize LSC's share of the proceeds (based on LSC's percentage interest) earned from the sale of LSC-funded real property to further LSC's mission per 45 C.F.R. Part 1631,[2] it is imperative that LSC maintains accurate real property records.

[1] Specifically, see 45 C.F.R. § 1631.14 Purchasing real estate with LSC funds, § 1631.17 Maintenance, § 1631.18 Insurance, § 1631.19 Accounting and reporting to LSC for specific requirements and § 1631.20 Disposing of real estate purchased with LSC funds.
[2] Specifically, see 45 C.F.R. § 1631.13 Use of derivative income from sale of personal property purchased with LSC funds, and § 1631.21 Retaining income from sale of real estate purchased with LSC funds.

AUDIT SCOPE AND OBJECTIVES

The objectives of this performance audit were to assess:

- The effectiveness and efficiency of LSC's oversight of its interest in grantees' real property, including fiscal accountability, compliance with LSC regulations and guidance, and LSC's compliance with accounting and financial reporting standards.
- The prior approval process, use of funds, policies and procedures, completeness and accuracy of recordkeeping, use of property, maintenance, insurance, accounting and reporting, and disposal of real property purchased with LSC funds.
- The use of income derived from the sale of real property.

To achieve these objectives, we assessed whether LSC and its grantees complied with the requirements of 45 C.F.R. Part 1631 and, where applicable, its predecessor, the Property Acquisition and Management Manual (PAMM), evaluated the adequacy of LSC's policies and procedures for managing and overseeing LSC's interest in grantees' real property, and tested the completeness and accuracy of LSC's real property tracking records.

This performance audit was designed to meet the objectives identified in the Objectives, Scope, and Methodology section of this report (**Appendix B**) and was conducted in accordance with *Government Auditing Standards,* referred to as Generally Accepted Government Auditing Standards (GAGAS), issued by the Comptroller General of the United States.

AUDIT RESULTS

We determined that LSC does not currently have sufficient policies, processes, and/or tracking mechanisms in place to effectively oversee its interest in grantees' real property and, as a result, does not currently have accurate records to support its real property interests. Further, we determined that LSC and grantees are not consistently maintaining documentation necessary to support that LSC-funded real property interests were appropriately approved, disposed of, and/or assessed annually in accordance with LSC regulations. Our testing identified issues with grantees' financial reporting of LSC-funded real property but did not identify any issues with LSC's compliance with applicable accounting and financial reporting standards, or with grantees' use of income derived from the sale of real property.

We provided a total of eleven recommendations to strengthen LSC's processes and procedures for approving, tracking, and maintaining accurate records of its real property interests and one suggestion for LSC to consider regarding its review of related-party rent expenses (**Appendix C**). We communicated our audit results, the related findings, and our recommendations to LSC and the LSC OIG. We included LSC's response to this report, in its entirety, as **Appendix A** of the final report.

FINDING 1: LSC'S CURRENT PROCESSES ARE NOT SUFFICIENT TO ENSURE IT IS EFFECTIVELY OVERSEEING ITS INTEREST IN GRANTEES' LSC-FUNDED REAL PROPERTY

Since 1998, the LSC OCE has had primary responsibility for monitoring grantee compliance with LSC regulations regarding LSC-funded real property. Specifically, OCE is responsible for receiving and processing grantees' prior approval requests, overseeing grantees' LSC-funded property transactions, and maintaining all relevant property records. However, we found that OCE does not:

- Maintain a complete inventory of LSC-funded real property and/or related documents.
- Effectively monitor its interest in grantees' real property.
- Ensure that grantees maintain and provide complete, reliable records of LSC-funded real property.
- Have documented policies that reflect its current processes and applicable real property regulations.

LSC Processes are Not Effective for Maintaining a Complete Inventory of LSC-Funded Real Property and Related Documents

LSC regulations[3] require that grantees submit a significant amount of documentation to obtain LSC approval to purchase LSC-funded real property and to execute property interest agreements. Although OCE's current process for tracking the grantee submitted information includes updating and maintaining an LSC-funded Real Property Financial Oversight Chart (Oversight Chart), a Box[4] Working Chart, and a Prior Approval Smartsheet,[5] our testing disclosed that many records are incomplete or missing from these charts. Specifically:

- OCE's Oversight Chart, which LSC noted it uses to identify all LSC-funded grantee real property, does not include all LSC-funded real property and is missing funded amounts for many of the properties listed. LSC representatives explained that it is the OCE Fiscal Analysts' responsibility to complete a Financial Statement Review Memorandum (FSRM) which includes instructions to update the Oversight Chart based on the Fiscal

[3] 45 C.F.R. Part 1631 and its predecessor, the PAMM, require grantees to submit documentation of real property acquisitions, including evidence of a market survey, cost or price analysis, independent appraisal, acquisition contract, and grantee board approval of the acquisition when requesting prior approval for the purchase of real estate.

[4] Box is a cloud-based file management system.

[5] Smartsheet is a Software as a Service (SaaS) offering for collaboration and work management. OCE has used Smartsheet since 2019; from 1998 to 2018 OCE recorded and tracked real property approvals on an Excel spreadsheet.

Analyst's annual review of grantees' financial statements. However, our testwork[6] identified 81 LSC-funded properties, 44 of which LSC did not appropriately track, as described below:

- 38 were real properties that the Fiscal Analysts did not capture on OCE's Oversight Chart.
- Six were real properties identified with no value or a value of "TBD" (to be determined).

- The Box Working Chart, which contains detailed descriptions of LSC-funded real property and which OCE noted is used to track the LSC-funded real property documents (e.g., prior approvals, property interest agreements) stored within its Box account, is not a complete inventory of all OCE's real property records. In response to our audit requests, OCE provided property interest documents for six properties that it did not record in its Box Working Chart.
- The Prior Approval Smartsheet (and its predecessor, described in footnote 5), which LSC noted is used to track LSC's real property prior approvals, did not record prior approvals for 10 LSC-funded real property sales that occurred between 2002 and 2012, as revealed by our testwork.[7]

We judgmentally selected[8] and tested 20 acquisitions of LSC-funded real property acquired between 1977 and 2022. OCE was unable to provide sufficient documentation for fourteen of the properties acquired prior to 2004 as follows:

- For three[9] of the acquisitions, OCE could not provide property interest agreements or evidence that the grantee requested prior approval from LSC for the acquisition.
- For the remaining eleven[10] acquisitions, OCE could not provide evidence that the grantee requested or received prior approval from LSC for the acquisition.

Because of the age of many of the relevant records, as well as the number of parties involved and multiple disparate systems used in its oversight, OCE faces many challenges in tracking, collecting, and maintaining required real property documents. For example, OCE does not have documented policies and procedures that define and detail the Fiscal Analysts' role and

[6] We sent questionnaires to 103 judgmentally-selected grantees (see Appendix B) inquiring about their acquisition and use of LSC-funded real property.
[7] Our testwork generated a list of 28 real property disposals occurring after 1998. This list was based on grantees' questionnaire responses, OCE's tracking records, and documents provided by OCE in response to our inquiries.
[8] We developed a list of LSC-funded real property based on LSC grantees' questionnaire responses. We used this list to select the random sample of 20 acquisitions.
[9] Total LSC funding for the three properties was $182,488.
[10] Total LSC funding for nine of these properties was $721,145 – the current grantee could not identify the LSC-funded amount for the remaining two properties which had been transferred from prior grantees.

responsibilities regarding LSC-funded real property oversight. Further, OCE representatives noted that the Box Working Chart is intended to be an initial research tool, not a complete list of all LSC-funded real property. Rather, LSC noted that it has built—but has not yet implemented—a real property module within *GrantEase*[11] that both grantees and OCE can use to store documentation related to the grantees' real property and reconcile LSC-funded real property amounts. However, LSC has not yet provided a target date for implementing the *GrantEase* real property module and there is currently no single authoritative source for maintaining and updating its real property records.

Missing real property records impede LSC's ability to oversee and monitor whether grantees are appropriately (1) completing all pre-purchase activities prior to purchasing real estate with LSC funds and (2) using, maintaining, insuring, accounting for, and disposing of real estate purchased with LSC funds in compliance with 45 C.F.R. Part 1631.[12]

LSC Processes are Not Adequate for Accurately Identifying or Monitoring LSC's Interest in Grantees' Real Property

During their annual review of grantees' financial statements, OCE Fiscal Analysts complete an FSRM which requires the Fiscal Analyst to provide responses to questions that enable LSC to identify and monitor LSC-funded real property. However, we found that LSC's current process is inadequate for identifying and monitoring LSC's interest in grantees' real property. Specifically, although the FSRM checklist includes questions regarding whether the grantee has LSC-funded real property and requires the Fiscal Analyst to document whether they have updated OCE's Oversight Chart, we found that LSC Fiscal Analysts are not appropriately completing these steps. We judgmentally selected[13] and reviewed the Fiscal Analysts' responses in 15 FSRMs of grantees' fiscal year (FY) 2022 financial statements and identified the following discrepancies:

- Five instances in which the Fiscal Analysts' responses to LSC-funded real property questions on the FSRM were erroneous and/or were not based on the Fiscal Analyst's review of the grantee's financial statements. Specifically:
    - Responses in two FSRMs indicated that the grantees did not have LSC-funded real property; however, the grantees' financial statements reported LSC-funded real property.

[11] GrantEase is LSC's grant management system and currently provides grantees with a grant management portal to use when accessing and managing LSC grant programs.
[12] Specifically, see 45 C.F.R. Part 1631, Subparts D, Real Estate Acquisition and Capital Improvements, and E, Real Estate Management.
[13] We judgmentally selected 15 FSRMs based on a comparison of OCE's Oversight Chart with the grantee questionnaire responses.

    - Responses in three FSRMs indicated that the grantees had LSC-funded real property but that no updates to the Oversight Chart were necessary. However, in all three cases, the grantees' financial statements reported LSC-funded real property balances that the Fiscal Analysts had not recorded on the Oversight Chart.
  - Three instances in which Fiscal Analysts did not appropriately update the Oversight Chart. Specifically, we noted that three FSRMs included responses indicating that the Fiscal Analyst had updated the Oversight Chart or that the Oversight Chart needed to be updated; however, the Oversight Chart that LSC provided for our audit showed the value of those grantees' LSC-funded real property as either no amount or "TBD". OCE later provided an updated Oversight Chart which showed that in January 2024 Fiscal Analysts had added LSC-funded amounts, totaling $598,401, for two of the grantees. However, the LSC-funded amount for the third grantee was still recorded as "TBD". Our testwork[14] found that this grantee had $3,102,407 of LSC-funded real property.

Based on our observations, the discrepancies described above occurred because OCE added additional real property questions to the FSRMs in 2021 without implementing sufficient FSRM policies and procedures or providing the Fiscal Analysts with sufficient guidance on performing the new review steps. As a result, the Fiscal Analysts do not appear to be fully aware of their responsibilities regarding identification and monitoring of LSC-funded real property. For example, we interviewed a Fiscal Analyst who indicated that she had not been aware she was responsible for updating the Oversight Chart when completing the FSRMs. In addition, because the financial statements that grantees use to satisfy the requirement of 45 C.F.R. § 1631.19[15] often do not contain enough detail to accurately identify the value of LSC-funded real property, Fiscal Analysts may not be able to accurately update and/or add real property information to the Oversight Chart.

OCE's current grantee financial statement review process is not adequate to oversee and monitor grantees' compliance with 45 C.F.R. § 1631.19 requirements for annual real property accounting.

LSC Processes Do Not Consistently Ensure Grantees Maintain or Provide Complete, Reliable Records of LSC-Funded Real Property

OCE does not have procedures in place to help ensure that grantees owning LSC-funded real property maintain sufficient documentation to accurately identify and value specific LSC-funded real property. OCE representatives stated that its last formal training for grantees on LSC real

[14] Grantee's response to our audit questionnaire.

[15] 45 C.F.R. § 1631.19, *Accounting and reporting to LSC*, requires grantees to provide an annual accounting of LSC funds used to pay for real estate acquisition, financing, and capital improvements.

property regulations was conducted when 45 C.F.R. Part 1631 became effective in December 2017. We identified significant issues with grantees' records retention, real property accounting, and real property use, including:

- LSC grantees did not always have LSC-funded property interest agreements on file. Thirty (30) of the 103 grantees to which we sent questionnaires during the performance audit[16] indicated that they had acquired real property with LSC funds. However, seven of these 30 grantees either did not state or stated that they did not have property interest agreements on file for 14 LSC-funded properties. For nine of these properties, OCE had a property interest agreement on file; however, for the remaining five properties, OCE did not have an agreement on file either.

- LSC grantees' financial statements did not always accurately report LSC-funded real property. Most LSC grantees that own LSC-funded real property use their annual financial statement audits to submit the annual LSC-funded real property accounting required by 45 C.F.R. § 1631.19. We reviewed the FY 2022 audited financial statements for the 30 grantees who identified LSC-funded real property on their questionnaire responses. We noted that, for two of these grantees, the financial statements did not include enough detail to identify LSC-funded real property. In addition, we found seven instances in which grantees' audited financial statements did not properly report LSC-funded real property values and thus did not comply with 45 C.F.R. § 1631.19. Specifically, we identified the following inaccurate and/or unsubstantiated information in grantees' FY 2022 financial statements:
    - ***Grantee A.*** The financial statement notes identified $2 million of an office building (i.e. 50 percent of the total cost) as LSC-funded real property. However, the grantee's Chief Financial Officer (CFO) stated that the grantee did not use any LSC funds to construct this building, and OCE could not identify any records indicating that LSC had helped fund this building.[17]
    - ***Grantee B.*** The financial statement notes identified a vacant lot valued at $40,326 as LSC-funded real property. However, in response to our questions, the grantee's Executive Director researched the grantee's records and determined that the grantee had not used any LSC funds to purchase this lot. OCE confirmed that the notes to the financial statements were incorrect.
    - ***Grantee C.*** The financial statement notes do not identify any LSC-funded real property. However, in response to our questions, OCE provided a February 1999 letter from the grantee indicating that, since it acquired the property in 1981, it

[16] We sent questionnaires to 103 Basic Field grant grantees asking each organization to identify and provide details regarding their LSC-funded real property.
[17] The grantee's CFO and auditors are still researching this issue.

had been using LSC funds each month to pay part of the mortgage on one of its office buildings.

- ***Grantee D.*** The financial statement notes identify one of the grantee's offices, valued at $75,000, as LSC-funded real property. However, OCE provided documentation obtained from the grantee in 1999 showing that the grantee did not use any LSC funding when purchasing this property.
- ***Grantee E.*** The financial statement notes do not identify any LSC-funded real property; however, OCE provided a real property agreement that LSC had executed with the grantee in September 2020, transferring a $47,951 LSC interest to one of the grantee's properties.
- ***Grantee F.*** The financial statement notes do not identify any LSC-funded real property. The grantee's questionnaire response was consistent with its financial statements, as the grantee indicated that it had acquired its office building without LSC funds. However, LSC provided a real property agreement allowing the grantee to finance $69,000 on the property and repay it with LSC funds.
- ***Grantee G.*** The financial statement notes do not identify any LSC-funded real property. However, the grantee's questionnaire response indicated that it had acquired one of its offices with LSC funds in 1978, and OCE provided a copy of the purchase agreement for this property.

- One LSC grantee was not using LSC-funded real property for LSC activities in accordance with 45 C.F.R. § 1631.16, which requires that grantees use real estate purchased with LSC funds to deliver legal assistance to eligible clients or for other activities if not needed for legal assistance. Specifically, we identified one instance in which a grantee indicated that its LSC funded real property was not currently in use:
    - ***Grantee H.*** The grantee's FY 2022 financial statements indicate it has LSC-funded real property that it acquired through a merger. In its response to our inquiries, the grantee identified this property as a previous office, but "now a vacant lot".

We found that these discrepancies were caused by LSC grantees not consistently creating, maintaining, retaining, and/or submitting sufficient documentation to accurately identify LSC-funded real property within the annual accounting of LSC-funded real property required by 45 C.F.R. § 1631.19. This inaccurate reporting appears to be in part the result of grantees not receiving adequate training on the requirements of 45 C.F.R. Part 1631 and/or their related responsibilities. Missing grantee property interest agreements and inaccurate financial reporting impede LSC's ability to ensure that LSC's interest will be protected if the grantees dispose of the real property.

OCE stated that it has evaluated concerns over the discrepancies identified and over the use of LSC-funded real property as they have come to its attention through its standard oversight activities. OCE noted that when LSC launches its *GrantEase* real property module, which will serve as a single repository for grantees' and LSC's real property documentation, grantees will be required to inform LSC of the value and use of their LSC-funded real property, and OCE will evaluate this information for compliance with 45 C.F.R. § 1631.16. However, as LSC has not yet provided a target date for implementing the *GrantEase* real property module, it is not evident when grantees will be able to upload the information necessary to allow LSC to complete its compliance evaluations.

LSC Processes are Not Accurately Documented

OCE's Policies and Procedures Manual, which outlines an approach for approving and tracking LSC's interest in grantees' real property, does not accurately reflect the processes that OCE told us they are currently using to oversee LSC's real property interests. Further, this manual still includes references to LSC's PAMM despite 45 C.F.R. Part 1631 superseding the PAMM as of December 31, 2017.[18]

OCE personnel told us that they have been working with a consultant since December 2022 to update OCE's Policies and Procedures Manual. OCE personnel expect to issue the updated manual by the end of 2024;[19] they have indicated that the updated procedures will include significant revisions regarding real property oversight and will reflect the most recent versions of the applicable regulations and OCE's current practices.

Finding 1 Conclusion

LSC's incomplete property records and lack of documented, up-to-date, applicable policies and procedures impact OCE's ability to effectively perform its oversight function. Specifically, we noted that missing real property records, inaccurate financial reporting, and outdated policies and procedures impede OCE's ability to ensure that it has an accurate inventory of LSC-funded real property, that grantees are properly maintaining and using LSC-funded real property, and that LSC's interest will be protected if/when grantees dispose of LSC-funded real property.

[18] Specifically, 45 C.F.R. Part 1631 restructured the PAMM requirements to improve the coherence and usability of the rules.

[19] As stated in OCE's response to Recommendation 8 (Appendix A). OCE subsequently notified the OIG that the updated Policies and Procedures Manual was completed on September 23, 2024, and that it will be effective as of January 1, 2025.

Finding 1 Recommendations

We recommend that LSC:

1. Review and inventory its own records and work with grantees to develop a single definitive and authoritative record of LSC-funded real property and supporting documents that is complete, accurate and consistently updated.

2. Compile a comprehensive list of LSC-funded real property for which no property interest agreements can be located and execute property interest agreements if necessary.

3. Implement the *GrantEase* real property module and use it as a tool to reconcile grantees' LSC-funded real property and supporting documents with OCE's records on an annual basis as part of the FSRM financial statement review.

4. Update its FSRM guidance to identify and clarify the Fiscal Analysts' roles and responsibilities regarding completion of the FSRM sections related to LSC-funded real property and updates to OCE's Oversight Chart.

5. Develop and implement a plan (with milestones) to provide training to LSC grantees on their responsibilities regarding LSC-funded real property, including retention of records, authorized use of property, and accurate annual reporting.

6. Require that grantees with inaccurate annual LSC-funded real property accounting work with their auditors to correct errors and certify to LSC that the errors have been corrected in the next fiscal year.

7. Work with Grantee H[20] to determine whether its LSC-funded vacant lot is needed for current operations or, if not, to dispose of the vacant lot in accordance with Subpart E of 45 C.F.R. Part 1631.[21]

8. Ensure that OCE's updated Policies and Procedures Manual accurately describes and addresses current regulations, as well as OCE's responsibilities as they relate to grantees' LSC-funded real property.

[20] The LSC OIG audit team has identified Grantee H, and all other anonymized grantees, within summaries provided to LSC during the fieldwork phase of the audit.

[21] Specifically, see 45 C.F.R. § 1631.20 Disposing of real estate purchased with LSC funds and 45 C.F.R. § 1631.21 Retaining income from sale of real estate purchased with LSC funds.

Finding 2: LSC Did Not Consistently Create or Maintain Sufficient Documentation to Support its Oversight of its Interest in Grantees' Real Property

During the late 1970s and 1980s, LSC's regional offices were responsible for prior approval of LSC-funded real property and for maintaining documentation regarding real property interests. It was not until 1999, after OCE was assigned oversight responsibility, that LSC developed a standard property interest agreement. However, based on an Office of Legal Affairs opinion, LSC could not require grantees that had acquired LSC-funded real property prior to this date to sign the new property interest agreement. When LSC issued the PAMM in 2001, it stated that the written agreement between the grantee and LSC would control for any acquisitions of real property prior to the PAMM's effective date. However, the PAMM was superseded in 2017 by 45 C.F.R. Part 1631, which sets forth LSC's requirements for purchasing, using, and disposing of real property acquired with LSC funds. As a result, we identified several issues that impact compliance with the current regulations and LSC's ability to protect its real property interests, including:

- Older LSC property interest agreements are not consistent with current LSC terms and conditions.
- Real property interest agreements were not required when LSC funded significant capital improvements.
- Capital improvements funded by LSC are not consistently accounted for or reported.

LSC's Older Property Interest Agreements Do Not Consistently Meet Current Regulatory Requirements

LSC has not attempted to renegotiate or work with grantees to amend property interest agreements executed before 2017 to help them comply with 45 C.F.R. Part 1631 requirements, terms, and conditions. Specifically, we noted that property interest agreements LSC executed before 45 C.F.R. 1631 was promulgated often do not include conditions that comply with the real property requirements of 45 C.F.R. Part 1631. For example, in our testing of a random sample of 20 LSC-funded real property acquisitions between 1977 and 2022, we identified:

- Two LSC-funded property interest agreements[22] did not explicitly address LSC's interest in the properties.[23] Specifically:

[22] In following up on discrepancies identified in OCE's real property records, we also reviewed a 1984 LSC-funded real property agreement with a grantee which does not identify LSC's interest in the property and was not signed by LSC.

[23] Both of the agreements do include requirements for prior LSC approval for disposition and for transfer of the real property to another grantee if the program ceases to exist.

        - A 1980 LSC-funded property interest agreement with Grantee I does not identify LSC's interest in the property. LSC funding of $60,000 was used to acquire the property.
        - A 1980 LSC-funded property interest agreement with Grantee J does not identify LSC's interest in the property. LSC funding of $33,500 was used to acquire the property.
    - Twelve property interest agreements that did not identify the applicability of LSC's current policies and procedures:
        - Twelve agreements executed between 1980 and 2006 either do not stipulate the number of days' prior written notice LSC must be given to approve disposing of a property or stipulate 30 days, neither of which is consistent with the current 45 C.F.R. § 1631.20(c) requirement for 60 days' prior written notice.
        - Seven of these agreements executed between 1980 and 2003 do not include requirements for grantees' annual accounting of LSC-funded real property.
        - Four of these agreements executed between 1980 and 2006 do not refer to applicable LSC regulations.

OCE representatives stated that LSC has not found that outdated terms in property interest agreements pose significant risks and that grantees normally work with LSC on real property matters in advance of any deadlines. However, periodic interactions between a grantee and LSC does not necessarily ensure that grantees will comply with the applicable requirements of 45 C.F.R. Part 1631, or that grantees will inform LSC of all relevant real property matters. Accordingly, we believe attempting to renegotiate the terms of older property interest agreements will help ensure that all grantees will comply with 45 C.F.R. Part 1631 requirements. Further, we believe this will reduce the possibility that LSC's interests will not be properly protected should a grantee dispose of the real property.

LSC Does Not Require Property Interest Agreements When Funding Significant Capital Improvements

Although LSC, at its discretion, can request property interest agreements when grantees use LSC funds to make capital improvements to grantee-owned real property, LSC does not execute property interest agreements unless the grantee used LSC funds to purchase the real property. As a result, we identified four grantees[24] whose FY 2022 financial statements and questionnaire responses support that they used LSC funds to make significant capital

[24] These grantees were identified in our comparison of the questionnaire responses with the FY 2022 financial statement note disclosures for grantees with LSC-funded real property.

improvements to real property in which LSC does not have a documented interest because the real property that was improved was not acquired with LSC funds:

- ***Grantee K.*** The financial statement notes identify $999,812 in LSC-funded capital improvements; however, they do not identify any of its buildings as LSC-funded.
- ***Grantee L.*** The financial statement notes identify $602,934 in LSC-funded capital improvements. However, in response to our inquiries, the grantee stated that it had not purchased any buildings or land with LSC funds.
- ***Grantee M.*** In response to our inquiries, the grantee stated that $144,507 of the LSC-funded property on its financial statements represented capital improvements to properties that it purchased with other funding.
- ***Grantee N.*** The financial statement notes identify $46,767 in LSC-funded real property. However, in its questionnaire response, the grantee identified these costs as capital improvements to properties that it purchased with other funding.

OCE representatives stated that, although they have discussed the merits of requesting agreements in circumstances in which a grantee spends significant LSC funds on a capital improvement, it does not currently require real property agreements when approving the use of LSC funds for capital improvements. Although not currently required by LSC policies, by not executing real property agreements when investing funds to improve grantee real property, LSC may not be protecting its interest in these properties.

LSC and Its Grantees Do Not Consistently Account for or Report Capital Improvements

Although 45 C.F.R. § 1631.19 states that a grantee's annual reporting must include LSC funds used to pay for acquisition costs, financing, and capital improvements, both OCE and LSC grantees are inconsistent in identifying and including capital improvement costs in their valuations of LSC-funded real property. Specifically, we identified the following inconsistencies:

- OCE does not consistently identify capital improvements within its Oversight Chart. Specifically, we noted that OCE's October 2023 Oversight Chart included LSC-funded capital improvements for only one grantee. Grantees' financial statements often do not separately identify capital improvements; however, we found at least ten grantees with LSC-funded capital improvements disclosed in their FY 2022 financial statements.
- Many grantees did not include the value of LSC-funded capital improvements when reporting the value of their LSC-funded real property in their questionnaire responses. In comparing LSC-funded real property from the questionnaire responses to the grantees' FY 2022 financial statements, we identified seven grantees that had not reported LSC-funded capital improvements in their questionnaire responses. For example, one grantee's FY 2022 financial statements identified $1,923,583 of LSC-funded capital improvements that the grantee did not include in the LSC-funded property identified in its questionnaire response.

LSC-funded property interest agreements reviewed during this performance audit did not consistently indicate whether the parties should factor capital improvement costs into the calculation of LSC's interest on disposition. Specifically, we noted that some of LSC's older agreements state that LSC's interest for the purchase "is equal to the proportionate amount of LSC funds used to support the purchase, including down-payment and mortgage payments." However, LSC's more recent agreements note that the value of capital improvements should be included in the calculation of LSC's interest by "setting LSC investment interest as equal to the percentage of the costs borne by LSC funds to purchase and renovate the Property, and LSC's proportional share of the value of any capital improvements based on the percentage of the costs for those capital improvements attributed to LSC funds".

Finding 2 Conclusion

Although 45 C.F.R. § 1631.15 requires grantees to maintain supporting documentation to accurately identify and account for LSC funds used to make capital improvements to the grantee's real estate not purchased with LSC funds, LSC has not developed policies and procedures to appropriately monitor and protect its interest in capital improvements to that real estate. Without properly recording and tracking its funding of capital improvements, LSC might not be able to ensure that grantees comply with applicable 45 C.F.R. Part 1631 requirements when they dispose of real property that LSC has invested significant funding to improve.[25]

Finding 2 Recommendations

We recommend that LSC:

9. Review existing property interest agreements for all LSC-funded properties to assess whether the agreement conditions (i) identify the applicable requirements of 45 C.F.R. Part 1631 and (ii) include language to ensure that the parties include the cost of LSC-funded capital improvements when determining LSC's interest in proceeds from disposition.

10. Issue guidance and negotiate with LSC grantees, if necessary, to amend existing property interest agreements, to ensure the agreements include the requirements of 45 C.F.R. Part 1631 and that LSC's interest in real property related to LSC's investment in capital improvements is protected.

11. Work with grantees without property interest agreements to identify LSC-funded capital improvement costs and assess whether the parties should negotiate agreements to protect LSC's interest in properties that the grantees did not initially acquire with LSC funds.

[25] Specifically, see 45 C.F.R. § 1631.20, Disposing of real estate purchased with LSC funds and § 1631.21, Retaining income from sale of real estate purchased with LSC funds.

OTHER MATTER: LSC DOES NOT REVIEW, APPROVE, OR EVALUATE RELATED-PARTY RENT EXPENSES

Although 45 C.F.R. § 1630.6(b) requires that grantees obtain prior approval to expend $25,000 or more in LSC funds for personal property purchases or leases, contracts for services, and capital improvements, it does not require LSC to approve grantees' real property rental agreements. Consequently, LSC grantees are able to execute lease agreements in excess of LSC's standard $25,000 approval threshold without LSC evaluating whether the rental agreements meet the requirements of 45 C.F.R. § 1630.5(a) and (b), and are reasonable, allocable, and negotiated at arms' length. In this audit, we identified two LSC grantees that are using LSC funds to pay rent to related parties at rates that LSC has not verified as reasonable:

- ***Grantee O.*** This grantee charged rent to LSC Basic Field grants for the use of facilities in a building owned by a separate entity, a limited liability corporation (LLC) of which Grantee O is the sole member. This entity charged rent not only to Grantee O, but also to other tenants. The grantee stated that it charges Grantee O a rent amount of $25 per square foot, which it noted was below market price, and that the rent is a proportionate amount of indirect expenses. Note 1 to the grantee's audited FY 2022 financial statements described the arrangement as follows: "The LLC was formed for the purpose of the purchase of debt-financed property where [Grantee O] is headquartered and generates rental income from tenants whose use of the facilities are related to the exempt purposes of [Grantee O]".
- ***Grantee P.*** This grantee charged LSC Basic Field grants for the rental of 10,000 square feet of space at a building owned by a joint venture. The grantee stated that Grantee P is the managing member of the joint venture. Although Note H to the grantee's audited FY 2022 financial statements stated that Grantee P is a member of the joint venture and briefly mentioned the building lease agreement, the note did not provide any information about the rental rate that the joint venture charges Grantee P.

As LSC regulations do not address the allowability of related-party costs, and as 45 C.F.R. § 1630.6 does not require prior LSC approval for grantees' real property rental agreements, we have not identified a finding related to these two properties. However, because 45 C.F.R. § 1630.5 notes that Office of Management and Budget (OMB) cost principles provide guidance on allowable costs,[26] and because the cost principles OMB published in 2 C.F.R. Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* generally

[26] 45 C.F.R. § 1630.5 states: "The regulations of the Office of Management and Budget shall provide guidance for all allowable cost questions arising under this part when relevant policies or criteria therein are not inconsistent with the provisions of the Act, applicable appropriations law, this part, the Accounting Guide for LSC Recipients, LSC rules, regulations, guidelines, instructions, and other applicable law".

stipulate that rental costs under related-party leases are limited to the lessor's cost of ownership,[27] we have reported this as an Other Matter.

Other Matter Conclusion

OCE representatives noted that OCE does verify the reasonableness of costs charged to LSC grantees by considering "generally accepted sound business practices, arms-length bargaining" and "[w]hether the grantee acted with prudence under the circumstances consistent with the requirements of 45 C.F.R. Part 1630". However, LSC does not require its personnel to review real-property rental agreements, and grantees' financial statements do not always provide sufficient information to indicate when they are paying LSC-funded rent to a related party. As a result, without requiring a specific review of the lease agreements and documentation to support rent charged to LSC grants, LSC cannot ensure that grantees are charging a fair and reasonable rent for the facilities in which the grantees operate.

Other Matter Suggestion for Consideration

We suggest that LSC consider:

12. Requiring LSC grantees to obtain prior LSC approval for any real property rental agreements for more than $25,000 when executed with related parties.

SIKICH CPA LLC SUMMARY OF LSC MANAGEMENT COMMENTS

LSC responded to the draft audit report via e-mail on August 29, 2024. LSC's response noted that it agreed with the general findings in the report and that it agreed with eight recommendations and partially agreed with three recommendations. They also partially agreed with the suggestion for consideration. We have summarized our evaluation of LSC's response, included in its entirety in Appendix A below.

Auditor Evaluation of LSC Management Comments

Although LSC management indicated that it agrees with the general findings in the report, it provided comments that it categorized as *Protecting LSC's Interest in Real Property*, *Identified Risks and Oversight Improvements Since 2000*, and *Clarifications Regarding Audit Findings* (Appendix A). We consider LSC management's comments responsive to the audit report, but noted the following with respect to the comments and clarifications provided:

- ***Identified Risks and Oversight Improvements Since 2000.*** We reviewed the statements included within LSC's management response and did not identify any inaccurate information. However, we noted the following:

[27] Specifically, see 2 C.F.R. § 200.465, *Rental costs of real property and equipment.*

- *LSC's Improved Oversight Processes*. Although we confirmed that fewer exceptions were identified with more recently produced records, our audit scope did not include an assessment of historical changes in OCE's oversight processes. Therefore, we cannot, and did not, evaluate the impact of each update LSC has made to its real property oversight processes since 2000.
- *Grantees' Treatment of Significant Gains*. Although we confirmed that we did not note any exceptions when testing the five sampled grantee real property dispositions, we did update the scope of our audit procedures to clarify that our audit only verified that grantees properly recorded gains on the sale of LSC-funded property as derivative income, as required by 45 C.F.R. §1630.17. Our audit did not include any additional testing of the grantees' handling of the proceeds from real property sales.

- ***Clarifications Regarding Audit Findings.*** We reviewed the finding clarifications provided by LSC management and noted the following:
  - *Prior Approval Tracking, Records of Interest Agreements Prior to 1991, and Prior Approval Records for Acquisitions Prior to 2004.* We confirmed that LSC's assertions about the age of the records where exceptions were identified are factually accurate. However, we disagree with LSC's assertion that its current systems for tracking prior approvals and real property agreements are sufficient. Because its current records are incomplete and do not support compliance with relevant regulations, we believe that LSC's current systems for tracking prior approvals and real property agreements require modifications. Accordingly, we have not made any updates to our report recommendations with respect to this matter.
  - *Accounting for Capital Improvements.* We disagree with LSC's assessment that an audit finding in this report is not supported by the example provided. The referenced example supports that we identified inconsistencies between the grantees' responses to our questionnaire and their audited financial statements. Grantees' failure to include capital improvement costs when identifying LSC-funded real property indicates a risk that grantees may not properly account for these amounts when quantifying LSC's interest in the sale of real property. Therefore, we have not changed the audit finding.

Auditor Evaluation of LSC Management Responses to Recommendations

The audit team considers LSC's proposed in progress actions to implement recommendations 1-5 and 7-11 as documented within its Recommendation Tracking spreadsheet, as responsive to the audit findings. We also consider LSC's proposed action to address our suggestion for consideration (labeled as 12) responsive to the other matter. However, we noted the following with respect to the comments provided for recommendations 6, 9 and 10 and the suggestion for consideration:

- ***Recommendation 6:*** We do not agree with LSC's assessment that grantees should not need to work with their auditors to correct errors in their LSC-funded property annual accountings. Because many LSC grantees submit their LSC-funded real property accounting, as required by 45 C.F.R. § 1631.19, with their annual financial statement audits, we believe that involving the grantee's auditors in the real property reconciliation process will result in more accurate and efficient real property accounting. Accordingly, we have not made any updates to this recommendation.

- ***Recommendations 9 and 10:*** We do not agree with LSC's assessment that it does not need to revise interest agreements with outdated terms. Because the current agreements often reference terms and conditions that are no longer applicable, we believe LSC grantees are more likely to understand which LSC terms and conditions apply to their current real property interests if their agreements are updated. Accordingly, we have not made any updates to this recommendation.

- ***Other Matter Suggestion for Consideration 12:*** LSC agreed that it can adopt measures to address the related party risks identified but suggested utilizing a different approach than creating a new prior approval requirement, as recommended. Because LSC's suggestion to collect this information through its basic field grant application forms addresses the related party risks identified, we noted no objection to LSC's proposed alternative.

The LSC OIG reviewed LSC Management responses to determine whether the 11 recommendations will remain open or whether any can be closed. The LSC OIG's evaluation is in Appendix D.

Sikich CPA LLC

October 18, 2024

APPENDIX A: LSC'S RESPONSE

August 29, 2024

Roxanne Caruso
Assistant Inspector General for Audit
Office of Inspector General
Legal Services Corporation

RE: Response to Draft Report - Performance Audit of the Legal Services Corporation's Oversight of its Interest in Grantee's Real Property

Ms. Caruso,

Enclosed for your review are the completed tracking form and links to supporting documentation relating to LSC Management's responses to the recommendations provided in the report referenced above. LSC Management's comments on the findings of the Office of Inspector General's (OIG) Draft Performance Audit of the Legal Services Corporation's Oversight of its Interest in Grantee's Real Property ("audit") are below.

LSC Management appreciates the report including references to the oversight improvements LSC has implemented or planned to implement independently of the audit findings. We agree or partially agree with the OIG's 11 recommendations and one suggestion for consideration.

As noted on the enclosed tracking form, LSC's efforts to address each recommendation are underway. These actions will further improve LSC's oversight of grantees' use of LSC funds to purchase or improve real property, LSC's interest in real property, and grantees' compliance with the related requirements.

Actions undertaken by LSC Management to address the OIG's recommendations include:

- The Office of Compliance and Enforcement (OCE) has developed a plan[1] to implement the *GrantEase* real property module.

[1] This plan and the plan to provide LSC grantees with the training referenced in the bullet below are attached to the OIG's Recommendation Tracking form submitted with this letter.

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www.lsc.gov

- OCE has developed a plan to provide LSC grantees with additional training on their responsibilities regarding real property purchased with LSC funds. This training will include guidance on, among other things, all real property requirements of 45 C.F.R. Part 1631, LSC's real property document retention requirements, and property interest agreements (e.g., purpose and terms).

- OCE is updating its guidance for OCE Fiscal Compliance Analysts regarding the review of grantee Audited Financial Statements (AFS) as it relates to real property and the OCE Real Property Financial Oversight Chart to clarify roles and responsibilities. OCE will provide training on the revised guidance and chart.

- OCE is in the process of issuing an updated Policies and Procedures Manual.

- OCE is working with Grantee H to determine whether its use of its LSC-funded property complies with Subpart E of 45 C.F.R. Part 1631.

LSC MANAGEMENT COMMENTS

LSC Management appreciates the professional and constructive manner with which the OIG and Sikich CPA LLP performed this audit. LSC Management agrees with the general findings and provides the comments below to offer additional information and clarifications.

Protecting LSC's Interest in Real Property

LSC retains an interest in grantee real property purchased in whole or in part with LSC funds. That interest represents the share of the property's value attributable to the LSC funds used for acquisition and capital improvements. This approach follows the model in federal grants. To best protect that interest, LSC requires grantees to record a statement of LSC's interest in the local government's real property records (usually by recording the property interest agreement between LSC and the grantee). That recorded statement puts all future buyers on notice and functionally prevents any grantee or former grantee from selling the property without addressing LSC's interest. The agreement also sets out some of the terms of LSC's interest in the property as understood at the time of purchase. At the time of sale, the grantee must obtain LSC's consent to release the interest and sell the property without any encumbrances.

Upon the sale or disposition of that property, current grantees must also comply with LSC's current requirements regarding real property, which appear at 45 C.F.R. Part 1631. Grantees certify at least annually that they agree to adhere to all LSC regulations by accepting LSC's Grant Terms and Conditions, which are attached to every basic field grant award. A grantee would be required to comply with 45 C.F.R. Part 1631 even if the regulation did not exist when the property was purchased. To obtain LSC's consent to release the recorded interest, the grantee must demonstrate that it has fully accounted for LSC's interest to the satisfaction of LSC. LSC requires the grantee to account for all uses of LSC funds to acquire the property or for capital improvements. Those funds are then considered derivative income and must be used as LSC funds by the grantee or returned to LSC. LSC has rarely encountered significant disputes regarding real property and only when a former grantee refused to comply with the applicable requirements. In those cases, LSC has prevailed in litigation.

Identified Risks and Oversight Improvements Since 2000

LSC recognizes the need to oversee grantees' use of LSC funds to purchase and improve real property, including LSC's interest in that property. LSC Management has included the Preservation of LSC's Interest in Grantee Property on its Risk Management Matrix since its creation in 2013.[2] It has also made several improvements over the last 13 years to its general oversight of grantees' use of LSC funds. LSC Management:

- Adopted regional team structures for both the Office of Program Performance and OCE and designated OCE compliance and fiscal contacts for each grantee. These assignments provide ongoing opportunities to identify compliance concerns more effectively and proactively and provide grantees with advice tailored to their specific needs;
- Developed a data-driven Risk Assessment Tool to focus LSC's oversight resources on the highest-risk areas and grantees;
- Expanded OCE's fiscal oversight capacity by hiring additional fiscal team members and issuing LSC's Financial Guide to allow LSC to provide grantees with a wider range of clear guidance on its fiscal-related requirements;
- Enhanced OCE's evaluation of annual funding and subgrant applications, including the review of grantee policies, to flag and resolve compliance and fiscal challenges before they become systemic; and
- Adopted Smartsheet as a tool to track OCE's myriad oversight processes to better manage and document that work

Over the last 24 years, LSC Management has also significantly improved its oversight of the use of LSC funds to purchase or improve real property and LSC's interest in those properties. In 2000, LSC published for notice and comment the Property Aquisition and Management Manual (PAMM) to govern the use of LSC funds to acquire, use, and dispose of real and nonexpendable personal property. LSC incorporated public comments and adopted the PAMM in 2001. The preamble explained that LSC previously had untenable, inconsistent, and varied real property oversight processes.[3] This area is more complex than many other areas of LSC's oversight work

[2] LSC Management identifies and ranks the principal risks facing LSC in the Risk Management Matrix, which it submits to the Audit Committee of the LSC Board of Directors at least quarterly.

[3] 66 Fed Reg. 47688 (Sept. 13, 2001) ("Notwithstanding the 1981 Audit Guide (or the current part 1630 requirements), the 1981 Property Manual, like its predecessor Instructions, does not address the acquisition, use or disposal of real property. LSC has instead established its policies relating to real property in a variety of internal memoranda, Program Letters, regulations, grant assurances and individual agreements with recipients purchasing real property which have either restricted the use or regulated the disposal of the property in the event of cessation of LSC funding. Having policies related to real property in such unconnected and disparate sources has

because of, among other things, the nature of real property ownership (e.g., long-term arrangements), the nature of LSC's interest in those properties, and LSC's evolving requirements in this area. Since 2001, LSC has continued to improve and expand its oversight of LSC-funded real property and has:

- Revised its real property requirements in 2017 and 2018, codified them in 45 C.F.R. Part 1631 (effective December 31, 2017), and provided grantees training on the new regulation;
- Expanded OCE's capacity to process real property approval requests through internal training and issued guidance on real property accounting and reporting to grantees via Program Letters 23-3, 19-1, 18-3, 17-1, and 16-7 (i.e., compliance advisories);
- Developed and implemented the use of a Real Property Prior Approval Smartsheet to track real property requests and inquiries;
- Scanned and saved hundreds of real property paper documents into LSC's electronic document management system;
- Engaged and worked with an outside consultant to update the OCE Policies and Procedures Manual, including a section on real property prior approvals;
- Built and is working to roll out an LSC-Funded Real Property module in its grant management system to serve as an authoritative source for information on each grantee's LSC-funded real property; and
- In 2021, recognized that additional oversight was needed and added questions relating to grantees' accounting for LSC-funded properties to OCE's Financial Statement Review Memorandum (FSRM), the tool it uses to evaluate each grantee's annual AFS.

Notably, the only missing documents identified by the audit involved transactions that occurred over ten years ago. Furthermore, the audit did not find problems with LSC's substantive or procedural process for reviewing and approving property purchases or sales. Nor did it identify concerns with LSC's compliance with applicable accounting and financial reporting standards. The audit also did not find any problems with grantees' treatment of the significant gains from LSC's interest in real properties, which became LSC derivative income after the sale of real property.

LSC Management will continue to improve its oversight processes to safeguard the investment of LSC funds for real property purchases and capital improvements, particularly in overseeing the grantees' accounting of LSC funds used to purchase and improve real property.[4] It will make

become untenable. For example, grant assurances on property have not been consistent over time and have on occasion been challenged as lacking legal authority.").

[4] As mentioned above, OCE added questions regarding real property to its FSRM in 2021. It recognizes, as noted in the audit, that it needs, and as such plans to issue, more guidance for OCE staff on answering these questions and will make improvements to the Real Property Oversight Chart.

the changes recommended in this report in a manner that takes risk, resources, and competing priorities into account. LSC Management agrees with Recommendation Nos. 1-5, 7-8, and 11. It partially agrees with Recommendation Nos. 6, 9, and 10, and the OIG's suggestion for consideration relating to related-party rental agreements. LSC Management's partial agreement with those recommendations is based on its belief that there are more efficient but equally effective ways to address the underlying risks. For example, Recommendation No. 10 suggests that LSC revise all previously signed interest agreements that do not "include the requirements of 45 C.F.R. Part 1631 and ensure that LSC's interest in real property related to LSC's investment in capital improvements is protected." LSC Management believes that, in many instances, it will be able to address the risks posed by older agreements that do not contain these terms more efficiently through training (in response to Recommendation No. 5), OCE's interest agreement review process (in response to Recommendation Nos. 1, 2, and 3), and its enhanced process to review grantees' annual accountings for each LSC-funded property (in response to Recommendation No. 6). However, it agrees that revised agreements will be required in some instances (e.g., the agreement terms would not put a potential purchaser on notice of the LSC interest or LSC believes a revised formal agreement is needed to address an identified concern).

Clarifications Regarding Audit Findings

LSC Management also provides the following clarifications of the facts underlying specific audit findings:

- Prior Approval Tracking. LSC has tracked real property prior approval requests since 1999. The audit identified no missing approvals on its tracking sheets from the last ten years. This indicates LSC does not have challenges with the current system for tracking these prior approvals.

- Records of Interest Agreements Prior to 1991. The audit's sample of twenty acquisitions between 1977 and 2022 did not find any missing interest agreements from LSC's files for acquisitions in the last thirty-three years. This indicates that LSC currently has a sufficient system for tracking and maintaining these agreements. The audit identified three acquisitions for which LSC could not provide property interest agreements. *Audit* at 4. Those acquisitions occurred in 1981, 1985, and 1987. The audit also identified five LSC-funded properties for which neither LSC nor the grantee had records of property interest agreements. *Audit* at 7. Those five acquisitions occurred before 1991. Gaps in LSC's historical records are a known problem. Nevertheless, LSC Management agrees it needs to remediate these risks and it will address these findings in its work to implement the audit report's recommendations.

- Prior Approval Records for Acquisitions Prior to 2004. The audit states that LSC Management "could not provide evidence that the grantee requested or received prior approval from LSC" for eleven purchases. *Audit* at 4. Each of these acquisitions occurred over twenty years ago and do not reflect LSC's current practices. Additionally, during the course of the audit process, LSC provided the OIG with documentation regarding prior approval in four of those purchases:

- For three purchases between 1978 and 1990, LSC provided signed agreements in which LSC authorized the use of LSC funds for the property acquisition.
- For one acquisition in 2002, LSC provided documentation of LSC's acknowledgement and approval of the grantee's receipt of the property from a former grantee. The former grantee had refused to recognize LSC's interest. LSC litigated the matter, proved its interest to the court, and obtained a Court Order resulting in the transfer of ownership to the current grantee.

- Accounting for Capital Improvements. The audit states that "OCE and LSC grantees are inconsistent in identifying and including capital improvement costs in their valuations of LSC-funded real property." *Audit* at 13. The audit provides two bulleted examples, one of which does not support the finding. The first example supports the finding and will be addressed by LSC Management through training and corrective action. The second bullet does not identify inconsistencies between OCE and the grantees regarding capital improvements and real property valuations. As stated in that bullet, all seven grantees referenced had identified the LSC-funded capital improvements in their annual AFSs provided to LSC, including the $1,923,583 of LSC-funded capital improvements noted by the audit. The bullet states that those seven grantees omitted that information in their responses to the OIG's questionnaire provided for this audit; however, OIG's questionnaire is not a part of OCE's records.

Lastly, LSC Management notes that the audit associates the amounts of LSC funds used for property-related costs with some findings. LSC appreciates these details being included in the audit and will evaluate whether any of the findings resulted in the misuse or loss of LSC funds.[5]

Thank you for the opportunity to provide comments before the OIG issues its final report.

If I or any member of the LSC staff can provide additional or clarifying information, please let me know.

Sincerely,

Ronald S. Flagg

Ronald S. Flagg
President

Attachments

[5] LSC Management also notes that, in LSC's experience, grantees appreciate having the option to use LSC funds for property purchases and improvements (e.g., ability to build equity), and are agreeable when resolving misunderstandings about LSC requirements or documentation discrepancies in manners that safeguard LSC's interests.

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Recommendation Tracking

The Office of Inspector General contracted with Sikich CPA LLC (Sikich) to conduct the performance audit of the Legal Services Corporation's (LSC) Oversight of its Interest in Grantees' Real Property. Sikich makes recommendations for actions or changes that will correct the problems, better safeguard the integrity of funds, and improve procedures or otherwise increase efficiency or effectiveness. We believe LSC management understands its 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.

Recommendations	Response	Comments
Recommendation 1	Agree ☒ Partially Agree ☐ Disagree ☐	In progress: As a part of the implementation of the GrantEase real property module (see comment to Recommendation No. 3), OCE will conduct an inventory of its own records. LSC built the GrantEase module in 2020, and it was designed to be the definitive, shared, and up-to-date location of information on LSC-funded property.
Recommendation 2	Agree ☒ Partially Agree ☐ Disagree ☐	In progress: As a part of the implementation of the GrantEase real property module (see comment to Recommendation No. 3), OCE will identify any properties for which no property interest agreements can be located. It will enter into any agreements, if necessary, to safeguard LSC's interests.
Recommendation 3	Agree ☒ Partially Agree ☐ Disagree ☐	In progress: In 2020, LSC created the GrantEase real property module to serve as a shared and authoritative location of information on LSC-funded properties. OCE plans to provide training on real property requirements and grantees' use of the module as a part of the implementation process. OCE intends to reconcile the grantee-provided information against LSC's records and resolve any discrepancies. To most efficiently and effectively conduct this reconciliation, OCE needed to scan a significant number of older

		non-electronic real property documents and save them in LSC's document management system. This process was delayed due to the LSC office closure during the COVID-19 pandemic and was completed this spring. OCE's implementation plan can be found here.
Recommendation 4	Agree ☒ Partially Agree ☐ Disagree ☐	In progress: OCE is developing guidance on completing the real-property related questions in the FSRM for Fiscal Compliance Analysts, revising OCE's Oversight Chart, and plans to conduct training for staff on this guidance and the updated chart by the end of October 2024.
Recommendation 5	Agree ☒ Partially Agree ☐ Disagree ☐	In progress: As a part of the implementation of the GrantEase real property module (see comment to Recommendation No. 3), OCE will provide grantees with training on, among other things, retention of real property records, authorized use of property, and accurate annual accounting.
Recommendation 6	Agree ☐ Partially Agree ☒ Disagree ☐	In progress: LSC Management agrees to require grantees to correct errors in their LSC-funded property annual accountings but does not agree it should require grantees to work with their auditors to do so. Under 45 C.F.R. § 1631.19, grantees are permitted to provide the annual accounting in or independent of their annual audited financial statements. LSC Management believes it would be more efficient and cost-effective for grantees to work directly with OCE to correct accounting records related to their LSC-funded property. Grantees should only engage their auditors to assist with making corrections if they cannot correct the required accounting on their own. OCE plans to address this recommendation through its annual review of grantees' audited financial statements (see comments to Recommendation No. 4).
Recommendation 7	Agree ☒ Partially Agree ☐ Disagree ☐	In progress: OCE has confirmed Grantee H is not using this LSC-funded lot and has been unsuccessful in its attempts to sell it since a fire destroyed the building in 2005. The grantee used the insurance proceeds from the fire to purchase a building it currently uses for office space. The only two offers Grantee H

		has received for the property since 2005 were for $2,408 and $4,000, and both were below the appraised value. In 2023, a tornado damaged the property, further complicating the grantee's efforts to dispose of the property. OCE is working with Grantee H to resolve this matter.
Recommendation 8	Agree ☒ Partially Agree ☐ Disagree ☐	In progress: OCE's updated Policies and Procedure Manual is in the final review stages and is expected to be issued by the end of 2024. OCE will continue to update the manual as it implements changes to oversight processes.
Recommendation 9	Agree ☐ Partially Agree ☒ Disagree ☐	In progress: LSC Management agrees it should review interest agreements for all LSC-funded properties and plans to do so as it implements the real property GrantEase module (see comment to Recommendation No. 3) to identify differences between their terms and the LSC requirements listed in the recommendation. It also agrees that revised agreements will be required in some instances (e.g., the agreement terms would not put a potential purchaser on notice of the LSC interest, or LSC believes a revised formal agreement is needed to address an identified concern). However, Management disagrees that all interest agreements not including the noted terms will need to be revised, specifically, where there is a more efficient way to address the risk of non-compliance (e.g., through regulations grantees have agreed to follow, training, work to correct grantees' annual accountings).
Recommendation 10	Agree ☐ Partially Agree ☒ Disagree ☐	See comments to Recommendation Nos. 5 and 9.
Recommendation 11	Agree ☒ Partially Agree ☐ Disagree ☐	In progress: LSC is collecting information on the amounts of LSC-funded capital improvement costs for which grantees sought prior approval since early 1999. LSC will collect additional information on capital improvement costs through the FSRM process (see comment to Recommendation No. 4) and develop standards for attaching an LSC

		interest to real properties for which a grantee used a significant amount of LSC funds to improve.
Recommendation 12	Agree ☐ Partially Agree ☒ Disagree ☐	Response to Other Matter for Consideration: In progress: LSC Management agrees that LSC can adopt measures to address the risk identified in this suggestion involving rental agreements with related parties that could affect whether grantees are paying fair and reasonable rent for their offices. However, it believes it can do so more effectively and efficiently with a different approach than through creating a new prior approval requirement in 45 C.F.R. Part 1631. LSC Management plans to instead collect information about these transactions through the basic field grant application forms submitted in May/June of each year. With rare exceptions, all LSC grantees apply annually for funding in the next grant year. LSC will revise its annual grant application form to request information on related parties and require grantees to upload any rental agreements with those parties. LSC Management can evaluate this issue as a part of LSC's funding application process and determine whether to conduct additional follow up. LSC Management does not need to impose a prior approval requirement to disallow costs that do not meet the reasonableness and allowability standards set out in 45 C.F.R. Part 1630.

APPENDIX B: OBJECTIVES, SCOPE, AND METHODOLOGY

OBJECTIVES

The LSC OIG engaged Sikich CPA LLC (herein referred to as "we") to conduct a performance audit. The objectives of the audit were to assess:

- The effectiveness and efficiency of LSC's oversight of its interest in grantees' real property, including fiscal accountability, compliance with LSC regulations and guidance, and LSC's compliance with accounting and financial reporting standards.
- The prior approval process, use of funds, policies and procedures, completeness and accuracy of recordkeeping, use of property, maintenance, insurance, accounting and reporting, and disposal of real property purchased with LSC funds.
- The use of income derived from the sale of real property.

SCOPE

The scope of the performance audit included reviewing LSC policies and procedures and the documentation LSC used to identify and track real property transactions as of April 12, 2023, the date the audit was announced.

METHODOLOGY

After obtaining LSC OIG's approval for our audit plan, we performed each of the approved audit steps. Generally, these steps included:

- Gaining an understanding of LSC regulations and guidance applicable to the audit objectives.
- Requesting and reviewing documentation provided to support LSC's tracking of grantees' real property transactions, including transactions related to acquisitions, sales, transfers, encumbrances, and dispositions.
- Assessing audit risks identified through interviews, prior audit report reviews, and analyses of LSC-provided documentation.
- Conducting virtual interviews with LSC personnel in Washington, DC to discuss relevant LSC-funded real property processes, policies, and procedures.
- Obtaining and reviewing LSC grantee real property records and LSC grantee financial statements to identify LSC grantees that held LSC-funded real property.
- Sending questionnaires to LSC grantees, requesting property, purchase, financial statement, market valuation, and disposition details for their LSC-funded real property.
    - Specifically, because we found that LSC's real property accounting records were not sufficiently reliable for the purposes of this audit, and because LSC grantee financial statement audit packages often did not include sufficient detail to

confirm LSC's interest in LSC-funded real property, we sent questionnaires[28] to verify the LSC-funded real property held by:

  - 72 grantees who reported real property (including capital improvements) valued at $100,000 or more.
  - 16 grantees whose FY 2022 audit reports were not publicly available.
  - 15 judgmentally selected grantees whose financial statements included either no real property or real property (including capital improvements) valued at less than $100,000.

- Using LSC grantee questionnaire responses to prepare a partial schedule of LSC-funded real property and using this schedule to identify discrepancies between LSC grantees' records related to LSC-funded real property and LSC's LSC-funded real property schedule.
- Selecting a judgmental sample of 20 LSC-funded real property acquisitions and performing testing to evaluate whether LSC maintained documentation to support that the grantee obtain LSC's approval for the acquisition, completed the acquisition, and monitored the acquisition consistent with LSC regulations.
- Selecting a judgmental sample of five disposals of LSC-funded real property and performing testing to evaluate whether the grantee complied with the LSC disposition requirements and followed LSC regulations regarding how to handle the disposition.
  - This included verifying that grantees properly recorded any gains it realized on the sale of LSC-funded property as derivative income, as required by 45 C.F.R. §1630.17.

We used non-statistical methodologies to select our samples for testing. Specifically, we used judgmental or random sampling methodologies, as appropriate, based on the audit scope and objective, as well as the audit timeline and the nature of the grantees. 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.

In planning and performing this audit, we considered LSC's internal controls within the audit's scope solely to understand the directives or policies and procedures LSC has in place to execute, approve, and monitor LSC's interest in grantee real property.
At the conclusion of our fieldwork, we provided a summary of our results to LSC OIG personnel for review. We also provided the summary to LSC personnel to ensure LSC was

[28] We sent questionnaires to 103 grantees and received responses from 102 of the grantees. We reviewed the 2022 audited financial statements for the grantee who did not respond and verified that it did not report any LSC-funded real property.

aware of each of our findings and that they did not have additional documentation to support the questioned costs.

We conducted this performance audit in accordance with *Generally Accepted Government Auditing Standards* (GAGAS), issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX C: SUMMARY OF FINDING RECOMMENDATIONS

We recommend that LSC:

1. Review and inventory its own records and work with grantees to develop a definitive and authoritative record of LSC-funded real property and supporting documents that is complete, accurate and consistently updated.

2. Compile a comprehensive list of LSC-funded real property for which no property interest agreements can be located and execute property interest agreements if necessary.

3. Implement the *GrantEase* real property module and use it as a tool to reconcile grantees' LSC-funded real property and supporting documents with OCE's records on an annual basis as part of the FSRM financial statement review.

4. Update its FSRM guidance to identify and clarify the Fiscal Analysts' roles and responsibilities regarding completion of the FSRM sections related to LSC-funded real property and updates to OCE's Oversight Chart.

5. Develop and implement a plan (with milestones) to provide training to LSC grantees on their responsibilities regarding LSC-funded real property, including retention of records, authorized use of property, and accurate annual reporting.

6. Require that grantees with inaccurate annual LSC-funded real property accountings work with their auditors to correct errors and certify to LSC that the errors have been corrected in the next fiscal year.

7. Work with Grantee H to determine whether its LSC-funded vacant lot is needed for current operations or, if not, to dispose of the vacant lot in accordance with Subpart E of 45 C.F.R. Part 1631.[29]

8. Ensure that OCE's updated Policies and Procedures Manual accurately describes and addresses current regulations, as well as OCE's responsibilities as they relate to grantees' LSC-funded real property.

9. Review existing property interest agreements for all LSC-funded properties to assess whether the agreement conditions (i) identify the applicable requirements of 45 C.F.R. Part 1631 and (ii) include language to ensure that the parties include the cost of LSC-funded capital improvements when determining LSC's interest in proceeds from disposition.

10. Issue guidance and negotiate with LSC grantees, if necessary, to amend existing property interest agreements, to ensure the agreements include the requirements of 45 C.F.R. Part

[29] Specifically, 45 C.F.R. § 1631.20 Disposing of real estate purchased with LSC funds and § 1631.21 Retaining income from sale of real estate purchased with LSC funds.

1631 and that LSC's interest in real property related to LSC's investment in capital improvements is protected.

11. Work with grantees without property interest agreements to identify LSC-funded capital improvement costs and assess whether the parties should negotiate agreements to protect LSC's interest in properties that the grantees did not initially acquire with LSC funds.

We also suggested that LSC consider:

12. Requiring LSC grantees to obtain prior LSC approval for any real property rental agreements for more than $25,000 when executed with related parties.

APPENDIX D: LSC OIG EVALUATION OF LSC MANAGEMENT COMMENTS

LSC OIG EVALUATION OF LSC MANAGEMENT COMMENTS

The OIG reviewed the information and documents LSC submitted with their response to the draft report to determine whether the recommendations had been satisfactorily addressed. LSC agreed with eight recommendations and partially agreed with three. LSC also partially agreed with the suggestion for consideration.

Although we reviewed the corrective action plan for the one suggestion for consideration, we did not include a determination as to whether the suggestion remains open or closed. The suggestion for consideration is considered advice for best practice and not a requirement for LSC to implement.

The OIG did not consider any responses from LSC as fully responsive and therefore did not close any recommendations.

The OIG considered the responses from LSC to Recommendations 1, 2, 3, 4, 5, 8, 9, 10 and 11 as responsive; however, these nine recommendations will remain open until LSC provides supporting documentation to the OIG as detailed in Figure 1.

Appendix D, Figure 1: List of Supporting Documentation[30]

Recommendation No.	Supporting Documentation Needed
1	A complete, accurate, and up-to-date inventory record of LSC-funded real property and its supporting documents.
2	A comprehensive list of LSC-funded real property for which no property interest agreements can be located and copies of new property interest agreements executed as a result of compiling the list.
3	Evidence of the implementation of the *GrantEase* real property module and evidence that it is reconciled to grantees' LSC-funded real property and supporting documents.
4	1) Updated guidance for grantees on completing the real-property related questions in the FSRM. 2) Revised OCE Oversight Chart. 3) Confirmation of training for staff on FSRM guidance and the updated chart.
5	Evidence of the implementation of the *GrantEase* real property module and evidence of training conducted for grantees on their responsibilities relating to LSC-funded real property.
8	Updated OCE Policies and Procedures Manual evidenced with formal management approval and effective date of implementation.
9	1) Confirmation that LSC Management reviewed all existing LSC-funded property interest agreements to assess whether the agreement conditions (i)

[30] These items are due to the OIG within six months from the date of the final report or by May 5, 2025.

Recommendation No.	Supporting Documentation Needed
	identify the applicable requirements of 45 C.F.R. Part 1631 and (ii) include language to ensure that the parties include the cost of LSC-funded capital improvements when determining LSC's interest in proceeds from disposition. 2) Copies of the revised agreements.
10	Copies of amended existing property interest agreements that include the requirements of 45 C.F.R. Part 1631 to ensure LSC's interest in real property related to LSC's investment in capital improvements is protected.
11	1) List of LSC-funded capital improvement costs for grantees without property interest agreements. 2) Result of assessment on whether the parties should negotiate property interest agreements.

The OIG considered the responses from LSC to Recommendations 6 and 7 as partially responsive. The OIG agrees with Sikich's analysis on Recommendation 6; we agree that involving the grantee's auditors in the real property reconciliation process will result in a more accurate and efficient accounting of real property. The OIG considers LSC Management's response to Recommendation 7 as partially responsive. LSC Management's response does not fully address the recommendation by completing one of the two recommended actions. Their response also does not detail an alternative corrective action plan with proposed actions to address the recommendation. The OIG considers these two recommendations open until LSC provides strengthened procedures and policies to the OIG as detailed in Figure 2.

Appendix D, Figure 2: List of Supporting Documentation[31]

Recommendation No.	Pending Specified Documentation
6	Evidence of the review of grantees' audited financial statements in addition with supporting statements indicating the corrected accounting records related to their LSC-funded property.
7	A corrective action plan to dispose of the vacant lot in accordance with Subpart E of 45 C.F.R. Part 1631.20 or a corrective action plan that provides an alternative resolution to address the finding.

[31] These items are due to the OIG within six months from the date of the final report or by May 5, 2025.