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United States Department of State  
and the Broadcasting Board of Governors  
Office of Inspector General

# **Report of Audit**

## **Review of Selected Grants Awarded to Institute for the Study & Development of Legal Systems**

Report Number AUD/CG-05-26, September 2005

### **~~IMPORTANT NOTICE~~**

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**United States Department of State  
and the Broadcasting Board of Governors  
Office of Inspector General**

**Office of Audits**

**Review of Selected Grants Awarded to  
Institute for the Study & Development of Legal Systems**

**Report Number: AUD/CG-05-26, September 2005**

**Regis & Associates, PC, Certified Public Accountants, performed the review under the Department of State, Office of Inspector General, Contract No. S-AQMPD-04-D-0040, and by acceptance the report becomes a product of the Inspector General.**

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**Howard J. Krongard  
Inspector General**

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**Date**

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### Summary

At the request of the Department of State's Bureau of Educational and Cultural Affairs (ECA), the Office of the Inspector General (OIG) contracted with Regis & Associates, P.C., to assess the Institute for the Study & Development of Legal Systems (ISDLS) operations and financial capacity as a "going concern". Additionally, Regis & Associates, P.C. was required to determine the usefulness of an audit of costs claimed and the availability of records to perform the audit. As a result of our assessment, we questioned approximately \$981,178 for the following reasons.

- Unexpended grant funds were not returned to the Department of State.
- Expenses were charged to an expired grant.
- Expenses charged to two grants were unsupported.
- Advances were requested and received approximately one year before the program was completed and expenditures incurred.

The following other matters, which require follow-on action, also came to our attention.

- General ledger expenses are not classified in accordance with the grants' budgets.
- Supporting schedules and other documentation for loans payable, payroll, payroll tax payable, and accounts payable were not maintained by ISDLS.
- ISDLS did not develop an indirect cost rate. The method used to apply indirect cost has not been consistently applied over the years.
- ISDLS relies heavily on grants from the Department of State. Without these funds ISDLS may cease to exist as a going concern.

Regis & Associates recommends that the ECA require ISDLS to reimburse the Department of State for unspent funds and unsupported and unallowable costs. Also, ISDLS should be required to maintain general ledger classifications that are consistent with grant budgets; maintain adequate support for loans payable, payroll, payroll tax payable, and accounts payable; and develop and apply indirect cost rate consistently. Based on the pervasiveness of the noted deficiencies, the Office of Inspector General recommends that ECA withhold or restrict future funding until ISDLS has corrected the identified deficiencies. We discussed these review results with ISDLS' management on February 11, 2005. The draft report was provided to ISDLS management for their comments, which was received on March 30, 2005. The entire text of the ISDLS responses is included as Attachment A to this report.

This report discusses each of the above findings in detail and presents our recommendations for resolution of the findings.

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## Background

The Institute for Study and Development of Legal Systems (ISDLS) is a non-profit corporation organized in May 1993 under the statutes of the state of California. ISDLS was organized for the purpose of studying the practical operation of foreign nations in designing and implementing legal modernization programs. ISDLS receives its funding primarily from federal government, particularly from the U.S. Department of State. Below is a summary of prior years funding, as follows:

**Table 1: Summary of Grant and Other Revenue Sources**

<b>Source</b>	<b>FY2001</b>	<b>FY2002</b>	<b>FY2003</b>	<b>TOTAL</b>	<b>% of Total</b>
Federal Programs	\$667,996	\$ 813,826	\$1,068,662	\$2,550,484	83
Nonfederal Programs	72,500	209,785	228,008	510,293	16
Interest	3,271	779	17	4,067	1
Total Revenue	\$743,767	\$1,024,390	\$1,296,687	\$3,064,844	100

Source: Analysis of ISDLS data by Regis & Associates, PC.

ISDLS' Board of Directors is comprised of legal professionals and businessmen from the State of California. ISDLS operates from one office and its primary mission is to conduct international legal reform and exchange projects in collaboration with foreign governments and legal professionals.

ISDLS has employed an average of four to five employees since 2000. ISDLS stated that it provides services mainly through volunteers who reside in most cases, in the United States of America. The Department of State awarded grants to ISDLS to provide services in several parts of the world including Egypt, India, Israel, Tanzania, Pakistan, Turkey, Malaysia, and Brazil. Between fiscal years 1995 and 2004, ISLDS received 21 grants totaling approximately \$4 million.

As a result of delays experienced by ECA in obtaining reports and other grant contract compliance information from ISDLS, ECA requested that the Office of Inspector General (OIG) conduct a review to assess ISDLS' operations and financial capacity as a "going concern", and to determine the usefulness of an audit of costs claimed and the availability of records to perform the audit.

### **Purpose, Scope, and Methodology**

The primary purpose of this agreed-upon procedures engagement was to provide the Department with an assessment of the ISDLS operations and financial capacity as a “going concern”, and to determine the usefulness of an audit of costs claimed and the availability of records to perform the audit.

We designed our approach to determine compliance with OMB Circular A-110, Uniform Administrative Requirements for Grants and Cooperative Agreements with Institutions of Higher Education, Hospitals, and Other Nonprofit Organizations; OMB Circular A-122, Cost Principles for Nonprofit Organizations; and OMB A-133, Audits of States, Local Governments and Nonprofit Organizations. We conducted the following test procedures.

- ✓ Reviewed the **compiled** financial statements and supporting reconciliation as of November 30, 2004. (Latest month available) A compilation is limited to presenting in the form of financial statements information that is the representation of management. Auditors have not audited or reviewed the financial statements and do not express an opinion or any other form of assurance on them;
- ✓ Obtained a list of active grants from 1/1/04 to the present and noted grant amounts and expenditures incurred;
- ✓ Reviewed bank statements for the past 12 months to identify levels of activity and liquidity;
- ✓ Inquired of the status of payroll tax liabilities identified in the audited financial statements;
- ✓ Verified that payroll and other taxes were paid;
- ✓ Inquired about the status of other payables and loans;
- ✓ Verified the status of loans payable;
- ✓ Reviewed loan agreements and rent agreement;
- ✓ Reviewed drawdown amounts on grants to determine whether drawdowns are advances or reimbursements for services rendered or cost incurred;
- ✓ Inquired about the method used to determine and apply indirect costs;
- ✓ Compared grant budgets and expenditures to actual costs claimed and drawdown amounts;
- ✓ Traced cash receipts from Department of State to bank statements on a sample basis; and
- ✓ Reviewed the general ledger, grant agreements, and modifications to each grant selected for unusual items.

In order to determine the availability of records to conduct an audit, we selected a sample of 7 grants from the list of 21 grants provided by the Department and requested samples of invoices for review.

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**Table 2: List of Grants Awarded to ISDLS**

RECIPIENTS	OFFICE	AGREEMENT NUMBER	TOTAL
Institute for the Study and Development of Legal Systems**	E/P	A-PSPS-G5190549	\$ 140,269
Institute for the Study and Development of Legal Systems**	E/P	A-PSPS-G5190048	\$ 528,022
Institute for the Study and Development of Legal Systems	E/P	A-PSPS-GS190082	\$ 131,979
Institute for the Study and Development of Legal Systems**	ECA/P/E	PECS-1087	\$ 185,727
Institute for the Study and Development of Legal Systems**	ECA/P/E	PEJL-0037	\$ 175,459
Institute for the Study and Development of Legal Systems	ECA/P/E	PEJL-0181	\$ 156,921
Institute for the Study and Development of Legal Systems	ECA/P/E	PEJL-1079	\$ 159,350
Institute for the Study and Development of Legal Systems	ECA/P/E	PEJL-1328	\$ 119,965
Institute for the Study and Development of Legal Systems**	ECA/P/E	PEMA-0098	\$ 170,512
Institute for the Study and Development of Legal Systems	ECA/P/E	PEMA-0172	\$ 150,000
Institute for the Study and Development of Legal Systems	ECA/P/E	PEPS-0112	\$ 66,758
Institute for the Study and Development of Legal Systems**	ECA/P/E	S-ECAPE-02-GR-046 (CS)	\$ 379,832
Institute for the Study and Development of Legal Systems	ECA/P/E	S-ECAPE-02-GR-094 (JJ)	\$ 164,829
Institute for the Study and Development of Legal Systems	ECA/P/E	S-ECAPE-02-GR-096 (MA)	\$ 164,940
Institute for the Study and Development of Legal Systems	ECA/P/E	S-ECAPE-02-GR-127 (JJ)	\$ 80,944
Institute for the Study and Development of Legal Systems	ECA/P/E	S-ECAPE-02-GR-140 (CS)	\$ 170,026
Institute for the Study and Development of Legal Systems	ECA/P/E	S-ECAPE-04-GR-115 (PS)	\$ 199,405
Institute for the Study and Development of Legal Systems	ECA/P/E	S-ECAPE-04-GR-121 (JY)	\$ 199,077
Institute for the Study and Development of Legal Systems	ECA/P/E	S-ECAPE-04-GR-122 (PS)	\$ 197,870
Institute for the Study and Development of Legal Systems**	ECA/P/E	S-ECAPE-04-GR-233 (JJ)	\$ 393,332
Institute for the Study and Development of Legal Systems	ECA/PE/C	181	\$ 22,140
<b>Recipient Total</b>			<b>\$3,957,357</b>

Source: Analysis of Department of State data by Regis & Associates, PC.

\*\* Sample grant selected for testing

We conducted the assessment at ISDLS office in San Francisco from February 7 through February 11, 2005.

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**Results of Review**

We identified four findings of noncompliance with applicable agreements and regulations. As a result, we questioned costs totaling approximately \$981,178, as summarized in Table 3 and detailed in the following paragraphs.

**Table 3: Findings and Questioned Costs**

<b>Finding</b>	<b>Amount</b>
<b>Unexpended Grant Funds not returned to the Department of State:</b>	
Grant # PEMA-0098-Tanzania	\$16,958
Grant # PEJL-0037 – Israel	671
Grant # PECS-1087 – Middle East	32,235
Grant # PSPS-G5190549 - Egypt	15,200
Grant # S-ECAPE-02-GR-046 (CS) – Turkey	18,396
<b>Charges to Expired Grant:</b>	
Grant # PSPS-G5190549 - Egypt	8,260
<b>Total Unallowable</b>	<b>91,720</b>
<b>Unsupported Grant Expenditures:</b>	
Grant # PSPS-G6190048 – India	528,022
Grant # S-ECAPE-02-GR-046 (CS) – Turkey	361,436
<b>Total Unsupported</b>	<b>889,458</b>
<b>Total Questioned Costs</b>	<b>\$981,178</b>

Source: Analysis of ISDLS data by Regis & Associates, PC.

**Unexpended Grant Funds Were Not Returned To the Department of State**

We noted that for five grants, total advances exceeded total amount of funds expended by \$83,460. OMB Circular A-110, Subpart D, Section 71, states that, "... (d) The recipient shall promptly refund any balances of unobligated cash that the Federal awarding agency has advanced or paid and that is not authorized to be retained by the recipient for use in other projects....". The detail is as follows:

**Grant # PEMA-0098-Tanzania**

Of the total advances of \$149,439, ISDLS spent \$132,481, with an unexpended balance of \$16,958.

We noted that the grant was originally awarded for \$134,742, and amended to \$170,512 with amendment #4. The grant period as amended on January 12, 2004 was from April 17, 2000 through June 30, 2004. ISDLS claimed that it terminated the grant but could not determine the exact termination date.

We noted that the last advance from the Department of State was dated December 16, 2003, and was for the expenses that would have been incurred for the period September 8, 2003 through March 31, 2004.

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**Grant # PEJL-0037 – Israel**

ISDLS received the total grant amount of \$175,459 between January 2000 and April 2001 for a grant that ended April 30, 2003. This grant was originally for \$120,504, but was increased to \$175,459 by Amendment #2 dated April 16, 2001.

Our review of the general ledger indicated that total grant expenses were \$174,788, resulting in an unexpended balance of \$671.

**Grant # PECS-1087 – Middle East**

This grant agreement specified the type of expenses that were allowed. However, the general ledger was not in agreement with the budget. We were unable to reconcile the indirect and direct administrative expenses and the office expenses recorded in the general ledger to the budget. In addition, the total expenses in the general ledger amounted to \$153,492 while the revenue from the Department of State amounted to \$185,727, resulting in a difference of \$32,235 in unexpended funds.

**Grant # PSPS-G5190549 - Egypt**

Receipts from the Department amounted to \$140,269 and expenses recorded in the contract's general ledger amounted to \$125,069, resulting in unexpended funds of \$15,200 that were not returned to the Department of State. Also, the grant expired on April 30, 1998, but expenses totaling \$372 was charged to the grant after the expiration date.

**Grant # S-ECAPE-02-GR-046(CS) – Turkey**

Receipts from the Department amounted to \$379,832 and expenses recorded in the contract's general ledger amounted to \$361,436, resulting in unexpended funds of \$18,396 that was not returned to the Department of State.

**Recommendation 1:**

We recommend that the Bureau of Educational and Cultural Affairs grants officer request that the Institute for the Study & Development of Legal Systems refund unexpended grant funds totaling \$83,460 to the Department of State for the following grants.

<b>Grant Number</b>	<b>Amount</b>
Grant # PEMA-0098-Tanzania	\$16,958
Grant # PEJL-0037 – Israel	671
Grant # PECS-1087 – Middle East	32,235
Grant # PSPS-G5190549 - Egypt	15,200
Grant # S-ECAPE-02-GR-046 (CS) – Turkey	18,396
<b>Total</b>	<b>\$83,460</b>

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**Expenses Were Charged To An Expired Grant**

**Grant # PSPS-G5190549 - Egypt**

Although this grant expired on April 30, 1998, we noted several transactions that were incurred and charged to the grant after the expiration date. OMB Circular A-110, Subpart C, Section 28, states that, "...Where a funding period is specified, a recipient may charge to the grant only allowable costs resulting from obligations incurred during the funding period and any pre-award costs authorized by the Federal awarding agency". ISDLS charged \$8,260 to the grant after the expiration date. The accounts charged and the amounts are presented below:

Delivery Expense	\$ 77
Flights	3,975
Local Travel	321
Per Diem	3,639
Photography	9
Supplies	16
Telephone Expense	<u>223</u>
Total	<u>\$ 8,260</u>

Upon review of our draft report, ISDLS indicated that it had transferred a portion of this amount to Grant No. PSPS-G9190126 based on ECA approval, leaving a balance of \$372 charged to Grant No. PSPS-G5190549 after the expiration date. We were unable to verify this statement.

**Recommendation 2:**

We recommend that the Bureau of Educational and Cultural Affairs grants officer disallow expenses totaling \$8,260 that were incurred and charged to Grant # PSPS-G5190549 after the expiration period.

**Expenses Charged To Two Grants Were Unsupported**

There were no invoices or other documentation to support expenses charged to Grant # PSPS-G6190048 – India, and Grant # S-ECAPE-02-GR-046 (CS) – Turkey. OMB Circular A-110, Subpart C, Section 21, states that, "...Recipients' financial management systems shall provide for the following. (1) Accurate, current and complete disclosure of the financial results of each federally-sponsored project or program in accordance with the reporting requirements set forth in Section 52. ...(2) Records that identify adequately the source and application of funds for federally-sponsored activities. These records shall contain information pertaining to Federal awards, authorizations, obligations, unobligated balances, assets, outlays, income and interest. (3) Effective control over and accountability for all funds, property and other assets. Recipients shall adequately safeguard all such assets and assure they are used solely for authorized purposes. ... (4)

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Accounting records including cost accounting records that are supported by source documentation.”

**Grant # PSPS-G6190048 – India**

Although the grant amount was \$528,022, we noted that on its project ledger ISDLS reported charges to the grant totaling \$626,938. This amount, which is also included in amounts shown on the ISDLS’ general ledger, constitutes expenditures of Federal funds, and may include funds from other grants according to ISDLS officials. We did not audit these amounts as ISDLS stated that the invoices supporting cost incurred may not be easily located and no invoices were available for our examination. The initial grant award was for \$376,013, which was subsequently increased to \$528,022 by amendment #5 dated January 11, 1999. However, there were no documents to support the charges to this grant. We noted that costs claimed for international, local, and domestic air travel exceeded the budgeted amount by 21%. Partial salaries exceeded the budgeted amount by 76% and other expenses exceeded the budgeted amount by 28%. The funds budgeted for honoraria expenses were not used for the budgeted purpose.

ISDLS also stated that the invoices supporting cost incurred may not be easily located and no invoices were available for our examination.

**Grant # S-ECAPE-02-GR-046(CS) – Turkey**

There were no invoices or other documentation to support the propriety of expenses charged to this grant totaling \$361,436.

**Recommendation 3:**

We recommend that the Bureau of Educational and Cultural Affairs grants officer disallow all unsupported expenses charged to Grant # PSPS-G6190048 – India, and Grant # S-ECAPE-02-GR-046 (CS) – Turkey.

**Advances Were Requested And Received Approximately One Year Before The Program Was Completed And Expenditures Incurred**

Our review of ISDLS advances on several grants indicated that substantial drawdowns were made on the grants, but the funds were not expended in many cases for several months. For example, ISDLS drewdown \$175,459 on Grant #PEJL-0037 between January 2000 and April 2001 for a contract that ended on April 30, 2003. OMB Circular A-110, Subpart C, Section 22, states that “...Recipients are to be paid in advance, provided they maintain or demonstrate the willingness to maintain: (1) written procedures that minimize the time elapsing between the transfer of funds and disbursement by the recipient, and (2) financial management systems that meet the standards for fund control and accountability as established in Section 21. Cash advances to a recipient organization shall be limited to the minimum amounts needed and be timed to be in accordance with

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the actual, immediate cash requirements of the recipient organization in carrying out the purpose of the approved program or project. The timing and amount of cash advances shall be as close as is administratively feasible to the actual disbursements by the recipient organization for direct program or project costs and the proportionate share of any allowable indirect costs.”

### **Recommendation 4:**

We recommend that the Bureau of Educational and Cultural Affairs grants officer communicate existing guidelines to the Institute for the Study & Development of Legal Systems regarding drawing down of funds. Specifically, funds should be drawn down within one month of being expended.

### **GOING CONCERN**

ISDLS receives about 83 percent of its revenues from Federal grants. Without these funds ISDLS may not be able to continue as a going concern.

### **Other Matters**

We reviewed the liability balances in the audited financial statements for fiscal years 2001 through 2003. ISDLS indicated that the reports for 2001 and 2002 were finalized and that the 2003 report would be finalized after ISDLS completes its review of the financial statements. We reviewed payroll taxes and noted that payroll taxes were paid for all three years. We traced the tax liabilities recorded in the payroll register to the bank statements. Payroll was processed for the most part by an outside servicer and deposits were made electronically.

We were unable to obtain supporting schedules for the balances in loan payable, payroll and payroll taxes payable accounts for all three fiscal years. However, ISDLS believes that the balances in the FY2001 report may be explained as follows:

1. The Loan Payable balance of - \$90,773 represents a \$73,774 loan from a bank and \$17,499 loaned to ISDLS by the Executive Director.
2. The Payroll and payroll tax payable balance of \$44,545 represents salary due to the Executive Director.

We reviewed bank documents and noted that ISDLS obtained a one-year loan for \$70,000. We agreed payments made to the bank statements and examined the checks that were paid to the bank. Per bank statements, we noted that the loan was repaid on 7/31/02. The management of ISDLS stated that the loan was collateralized by a certificate of deposit (CD) purchased by 10 board members. We found no documentation supporting the collateralization agreement with the 10 board members or the repayment to them when the CD was redeemed. However, we noted that there was a CD.

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According to ISDLS, in FY02:

1. The loan payable in the previous year was reduced by \$17,499 when the loan was repaid.
2. Payroll and payroll taxes increased because the executive director's salary was not paid.

The management of ISDLS stated that in FY2003, liabilities increased mainly because the executive director's salary was accrued but not paid. We could not verify the salary due to the executive director because ISDLS did not provide schedules or any form of documentation supporting the salary structure for employees, including the executive director. Also, ISDLS' efforts to obtain supporting documentation from the auditors were not successful.

ISDLS currently has hired an outside accountant who prepares monthly compilation reports. We noted that compilation reports were prepared through November 2004. We reviewed the general ledger, disbursement journals, and reconciliations for unusual amounts. We did not note any unusual amounts.

We also noted that ISDLS did not submit an audit report to the Department under Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations.

### **Recommendation 5:**

The Office of Inspector General recommends that ECA withhold or restrict funding ISDLS grants until ISDLS has corrected the deficiencies identified in this report.



**INDEPENDENT ACCOUNTANTS' REPORT ON APPLYING  
AGREED-UPON PROCEDURES**

U.S. Department of State  
Office of Inspector General  
Office of Audits  
1700 North Moore Street  
Arlington, VA 22209

Regis & Associates have applied certain agreed-upon procedures (the Procedures), as summarized in the Objectives, Scope, and Methodology section of this report, to the Institute for Study and Development of Legal Systems (ISDLS) grant financial activities.

The Procedures, which were agreed to by the Office of Inspector, were performed to assess the ISDLS operations and financial capacity as a “going concern”, and to determine the usefulness of an audit of costs claimed and the availability of records to perform the audit.

This agreed-upon procedures engagement was performed in accordance with standards established by the American Institute of Certified Public Accountants, Generally Accepted Governmental Accounting Standards, and the Federal Acquisition Regulations. The sufficiency of the Procedures is solely the responsibility of the specified users of the report. Consequently, we make no representations regarding the sufficiency of the Procedures, either for the purpose for which this report has been requested, or for any other purpose. Our test procedures revealed four findings. These findings and the associated recommendations are presented in the “Findings and Questioned Costs ” section of this report. Where appropriate, we have also presented as “Other Matters for the U.S. Department of State’s Consideration”, other observations that we noted during our review.

We were not engaged to, and did not perform an audit, the objective of which would be the expression of an opinion on the specified elements, accounts, or items. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the use of the U.S. Department of State, Office of Inspector General, and should not be used by those who have not agreed to the procedures, and taken responsibility for the sufficiency of the procedures for their purposes.

Regis & Associates, PC  
February 11, 2005

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**Attachment A - ISDLS Responses**

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March 30, 2005

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RE: The Review of Selected Grants Awarded to ISDLS  
Report Number: AUD/CG-05-26  
March 2005

Dear Mr. Abassi:

On March 21, 2005, ISDLS received a copy of "The Review of Selected Grants Awarded to ISDLS" ("the Review"), generated by a Regis & Associates auditor. While assessing ISDLS, the auditor came to a number of conclusions about the Institute's operations and financial capacity. This document is intended to expand upon some of the factual findings and to challenge, where appropriate, some of the auditor's conclusions.

ISDLS is a non-profit corporation organized in 1993 under the state laws of California. The primary work of the corporation is to initiate and guide the reform of legal dispute resolution processes in countries that suffer from crippling delays in the resolution of civil and/or criminal legal disputes. (At certain times, ISDLS has been specifically invited to undertake reform efforts in the intellectual property / piracy areas and in the judicial corruption area.)

The above-defined areas are very difficult to work in, as the problems which result in backlog and delay have generally existed for many years, and have become part of countries' legal cultures. Nevertheless, because of global competition and/or criticism from international institutions (the United Nations, the World Bank, Amnesty International), governments elect to undertake reform and to work with ISDLS to initiate their reform efforts.

Each of our reform projects requires the working collaboration of three groups: ISDLS, the respective U.S. Embassies in the partner country, and a host country Legal Study Group (LSG). The LSG is ordinarily comprised of leading legal opinion leaders from both government and non-government legal institutions active in the resolution of civil and criminal disputes, i.e. judges, lawyers, prosecutors, and law professors. This group of people, usually between six and ten in number, is responsible for the advancement of the reform effort in the partner country.

The LSG conducts a legal study in the United States, and California ISDLS legal experts travel to the foreign country to facilitate understanding and to consult on implementation strategy through exchange programs. The LSG works in the United States to study the Californian models for civil and criminal reform, which were created in the 1980s and have served as the models for the civil and criminal reforms exported to other U.S. States and the United Kingdom. These California models are presented by the California experts who created the models and who also volunteer their services to ISDLS in all legal studies. ISDLS, in turn, sends teams of legal experts to the foreign country. Approximately eighty such experts volunteer their time to the ISDLS-ECA projects. (Over the past twelve years ISDLS has utilized only three contractors, all serving only as legal reporters of various projects.)

ISDLS has a very small staff to coordinate all of its reform activities, usually including four personnel: an Executive Director, one to two program coordinators, and a financial officer. ISDLS' maintains a monthly overhead of approximately \$33,000. ISDLS is active in the fundraising area and, over the past three years, has raised \$96,585.91 (2002), \$115,150 (2003), and \$225,322 (2004) from private sources. In 2005, ISDLS expects to raise \$175,000 or more.

Since its 1993 incorporation (and not before), ISDLS has regularly received grants from the Office of Citizen Exchanges, Bureau of Educational and Cultural Affairs, U.S. Department of State ("ECA"). These individual grants have varied in size from approximately \$100,000 - \$400,000, with the great majority being in the \$150,000 - \$200,000 range.

ECA expects that ISDLS will attempt to initiate legal reform; ECA does not expect ISDLS to conduct the reform itself, however, as the problems addressed by the grants are deeply entrenched, requiring extensive study and acceptance by the legal actors in these countries. Because of the many challenges that arise during the reform efforts, including changes in critical government personnel and opposition to reform stronger than originally expected (albeit temporary), the projects are frequently delayed. Because of these delays, virtually all grants require amendments to extend the period of performance of the contract (usually extending projects to three to five years in age) and / or to adjust the administrative allocations in the grant. ISDLS has submitted innumerable amendment requests, all but one (Grant # PSPS-G5190549 – Egypt) of which have been approved in a timely fashion.

Further, ISDLS attempts to posture the reform efforts in such a way that countries can continue the ISDLS-initiated efforts with larger legal reform grantors, such as USAID or the World Bank. When such grantors are not immediately available, ISDLS seeks successive ECA grants to advance and finalize the legal reform efforts in direct collaboration with the partner government (as is the case in Egypt, India and Turkey).

Since its incorporation, ISDLS has had a single office in San Francisco. All of its ECA grant records are kept in a storage cabinet in the Executive Director's office (including grant agreements, grant amendments, and documents, receipts and invoices supporting expenditures). Records of extensive legal reform activities prior to ISDLS' incorporation in 1993 are not kept in the ISDLS office.

George Roque served ISDLS as an outside supervisory accountant from 1996 until 2003. All financial documents were outsourced to him for processing, and Mr. Roque was responsible for budgeting and reporting financial position on all grants to ISDLS management and to grantors. From May 2003 until September 2004, ISDLS was not able to retain an outside supervisory accountant. ISDLS relied on an in-house Stanford-educated accountant / office manager (May 2003 – March 2004) and a Haas Business School-educated MBA (May 2004 – September 2004) to manage and report on all financial matters. Both of the accountants serving from May 2003 until September 2004 were strictly responsible and completely relied upon for managing the financial aspects of ISDLS; they played no role in any programmatic component of our operations. They made regular financial reports to ISDLS management, indicating that all financial issues were in order, reports were sent to ECA prior due dates stipulated in grant agreements, etc. During an audit of the 2003 financial statement audit in accordance with OMB circular A-133, conducted in October 2004 by an independent CPA firm, it was discovered that financial records had not been adequately maintained by either of the financial officers serving from May 2003 to September 2004. This was the first instance in which ISDLS management became aware of the previous accountants' financial underperformance. Had checks and balances systems been in place for an annual financial review, ISDLS management would have been aware of the underperformance at an earlier date. Specifically, salary and indirect cost items were not properly allocated to individual grants, and financial reports were not regularly submitted to ECA. The issue is currently being addressed by the internal and external ISDLS financial officers and the contracted auditing firm.

In order to ensure accuracy in the Review, I believe that some issues merit clarification from the management of ISDLS. I have outlined the issues below.

1. General Operations (Supporting Schedules):

- a. Issue: (From "Summary," page 1, 6<sup>th</sup> point): "Supporting schedules and other documentation for loans payable, payroll, payroll tax payable, and accounts payable were not maintained by ISDLS."
- b. Response: ISDLS did maintain schedules and documentation for loans payable, payroll, payroll tax payable, and accounts payable over the years. On the topic of loans payable, ISDLS has a verbal agreement with Executive Director Stephen Mayo regarding his loan to the company. ISDLS will implement a system to document this loan payable with a note. On several occasions, personnel turnover in the financial officer position resulted in implementation of different documentation systems. To remedy this and other issues, ISDLS has begun developing sound documentation systems. Further, ISDLS took the proactive step to hire Donna Cohen, a highly experienced CPA, in mid-2004 to synthesize the

past processing and reporting systems and to develop a consistent, OMB circular-compliant, and globally-applicable system to support all financial schedules and documentation for the abovementioned accounts. Donna Cohen is retained by ISDLS as a permanent outside financial manager and advisor. The system that she designed for ISDLS has been refined and implemented.

- i. From Donna Cohen's Engagement Letter with ISDLS: "Design a customized chart of accounts...including appropriate functional breakdowns, and cost centers." "We will input all transactions...prepare account analyses, record journal entries, allocate payroll, reconcile bank statements, and perform any additional work needed to prepare accurate GAAP basis financial statements." (The full Engagement Letter can be furnished upon request.)

2. General Operations (Indirect Cost Rate):

- a. Issue: (From "Summary," page 1, 7<sup>th</sup> point): "ISDLS did not develop an indirect cost rate. The method used to apply indirect cost has not been consistently applied over the years."
- b. Response: Prior to 2004, ISDLS has consistently applied an *approved* indirect cost rate of 24.5% (of total salaries) over the years, pursuant to the past indirect cost rate submissions specified in its ECA grant agreements. In its four new 2004-2005 grant agreements, however, ECA specified a new provisional indirect cost rate of 49%, which has been applied.
- c. Supporting Documentation: Please see **Attachment A**, which includes copies of four separate grant agreements indicating that ISDLS has developed and used an indirect cost rate of 24.5% for ECA grants issued before 2004, and a provisional rate of 49% for ECA grants issued in or after 2004.

3. General Operations (Heavy Reliance on Department of State):

- a. Issue: (From "Summary," page 1, 8<sup>th</sup> point): "ISDLS relies heavily on grants from the Department of State. Without these funds ISDLS may cease to exist as a going concern."
- b. Response: ISDLS raised \$96,585.91 in 2002, \$115,150 in 2003 and \$225,322 in 2004 from private sources. Significant fundraising efforts have provided ISDLS with the cash flow necessary to carry out all activities that are necessary to advance ECA-funded projects, but that are not covered by ECA or other nonfederal grants. ISDLS raises enough capital to cover its own operating expenses for almost seven months, without utilizing any federal grant funds.

- c. Supporting Documentation: Please see **Attachment B**, which includes copies of the ISDLS “Contributions” ledgers.
4. General Operations (Use of Contractors):
    - a. Issue: (From “Background,” page 2, 3<sup>rd</sup> paragraph): “ISDLS provides services mainly through contractors who reside in most cases, in the United States of America.”
    - b. Response: The legal experts who participate in ISDLS projects are unpaid volunteers, not contractors. ISDLS has offered remuneration to only three of its 80 legal expert affiliates (Hiram Chodosh, Peter Nunez and Herman Schwartz) throughout the organization’s history.
  5. Grant # PEMA-0098 - Tanzania
    - a. Issue: Of the total advances of \$149,439, ISDLS spent \$132,481.30, with an unexpended balance of \$16,957.70.
    - b. Note: In early 2004, ECA advised that ISDLS should cease activity in PEMA-0098. While ISDLS initiated the judicial corruption project in good faith (augmented by a participation agreement from the Chief Justice of Tanzania), it became apparent during the life of the project that disbursement of insufficient judicial salaries was the primary cause of judicial corruption. In consultation with the U.S. Embassy in Tanzania, it was decided that the project would not result in positive reform if the Executive Branch of the Tanzanian government refused to participate in the project by addressing the judicial salaries issue, or if a well-endowed institution would not invest in a large-scale reform project. Neither of these requirements were met. For this reason, ISDLS ceased operations in PEMA-0098. The funds remaining in PEMA-0098 were not requested (nor were they received) by ISDLS.
    - c. Response: Our records show that total costs incurred under PEMA-0098 are higher than those cited by Regis Associates. The actual costs incurred equal \$149,691.97 during the allowable period of the agreement, not \$132,481.30 as indicated by Regis Associates.
    - d. Supporting Documentation: ISDLS records show that the costs incurred under PEMA-0098 amount to \$149,691.97, leaving an unexpended balance of \$252.97. **Attachment C** is a cover sheet comparing the items of expenditure to the budget line items established in Amendment A004 of the agreement. **Attachment C** is the ledger that supports these figures.

- i. Since the Review, the Tanzania ledger has been updated to include indirect costs expenditures for the period of 6/30/03 through 6/30/04. Full documentation supporting these expenditures was available for review at ISDLS at the time of the inspection. However, the indirect expenditures had not been entered into the ledger, due to the reasons explained in the introductory remarks, i.e. the ISDLS management recently learned that ISDLS financial officers serving from May 2003 until September 2004 were incompetent to duty and did not maintain the ledger properly.

6. Grant # PECS-1087 – Middle East

- a. Issue #1: (From page 6, 3<sup>rd</sup> paragraph): “This grant agreement specified the type of expenses that were allowed. However, the general ledger was not in agreement with the budget.”
- b. Response: An analysis of No-Cost Amendment number A003, approved by ECA Grants Officer Connie Stinson on August 9, 2004 and confirmed by ISDLS Executive Director Stephen Mayo on September 3, 2004, reveals that the budget was amended to include the following line items:
  - i. Program Expenses: \$91,227
  - ii. Administrative Expenses:
    1. Partial Salaries and Benefits: \$66,100
    2. Office expense: \$3,000
    3. Indirect Expenses: \$25,400

Amendment A003 is located in the top pages of the file that contains our only copy of the original grant agreement, which was referenced by the auditor. Amendment A003 was overlooked during the Review.

- c. Issue #2: (From page 6, 3<sup>rd</sup> paragraph): “We were unable to reconcile the indirect and direct administrative expenses and the office expenses recorded in the general ledger to the budget.”
- d. Response: The budgets submitted and incorporated into the grant agreements, both original and amended, specified only direct and indirect office expenses. There was no mention of more specific types of expenses.
  - i. When the final form of an agreement is in writing, the final terms control. In this case, those terms are only those items that fall under either the direct or indirect administrative costs description. Further, in this case, neither the budgets nor the agreements themselves specified any type of expenses beyond indirect and direct administrative expenses.
  - ii. In reconciling office expenses as either direct or indirect, ISDLS follows the rules of classification as understood and explained by its past financial officer. That is, direct office expenses are those expenses that would not

accrue but for the existence of the agreement, i.e., postage, photocopying, telephone calls, etc. Indirect expenses are those expenses that would accrue despite the existence of the agreement, i.e., occupancy rental, furniture and computer rental, telephone service charges, etc. These costs are covered by the pool of money established by the agreement which, in the case of the original and amended agreements, varied b/n 24.5% and 49%.

1. Office of Management and Budget Circular No. A-122, Attachment A, Sec. B(1): Direct costs are those that can be identified specifically with a particular final cost objective, i.e., a particular award, project, service, or other direct activity of an organization. Costs identified specifically with other final cost objectives of the organization are direct costs of those cost objectives and are not to be assigned to other awards directly or indirectly.
  2. It should be noted that the costs incurred for direct and indirect costs by ISDLS in the Middle East Rule of Law Project did not exceed the budgeted amount.
- e. Issue #3: (From page 6, 3<sup>rd</sup> paragraph): "...the general ledger was not in agreement with the budget," and "...the revenue from the Department of State amounted to \$185,727, resulting in a difference of \$32,234.89 in unexpended funds."
  - f. Response: Rather than the unexpended sum of \$32,234.89, the general ledger indicates that ISDLS overspent the grant by \$2,192.18. ISDLS used outside contributions to cover these additional expenses.
  - g. Supporting Documentation: Please see **Attachment D**, which includes the amendment request, the actual amendment provided by ECA, and the PECS-1087 ledger.
7. Grant # PSPS-G5190549 – Egypt
- a. Issue: (From page 6, 3<sup>rd</sup> paragraph): "...the grant expired on April 30, 1998, but expenses totaling \$15,631.48 was charged to the grant after the expiration date."
  - b. Response: The ISDLS ledger shows that expenses totaling \$371.78 were charged to the grant after the expiration date, not \$15,631.48.
  - c. Prior to the contract expiration date, ISDLS made an application to extend the life of the grant. It was advised that it would be granted, just as all prior amendment requests had been granted. Relying on this advice, ISDLS began planning a national criminal justice seminar for March 1999 in Cairo at the behest of the Egyptian Prosecutor General, USDOS and the U.S. Embassy in Egypt. During

the planning phases, high-profile Egyptians and Americans changed their schedules to accommodate their involvement in the highly-anticipated seminar. After approvals were received and schedules were changed, ISDLS was politically required to move forward with the seminar.

- d. For reasons beyond the control of ISDLS, the extension request was not approved prior to the expiration date. Upon direction by ECA, ISDLS filed a petition to reopen the grant for the purposes of appealing for a grant extension. In early 1999 the ECA panel accepted (and the Undersecretary of USDOS issued a signature of approval for) the amendment request and agreed to extend the grant for one year. ISDLS continued to incur expenses associated with the national criminal justice seminar, allocating the expenses to PSPS-G5190549.
- e. Just before the commencement of the seminar, a USDOS grants officer cited a federal statute that would require USDOS to issue a *new grant instead of* reopening PSPS-G5190549. For this reason, USDOS issued grant # PSPS-G9190126, which included a budget for the national criminal justice seminar in Cairo.
- f. While conducting a year-end financial review, the ISDLS financial officer serving in 1999 credited all expenses allocated to PSPS-G519059 *after* April 30, 1998 (the expiration date), and reallocated these expenses to the new grant, PSPS-G9190126. This reallocation occurred on December 31, 1999. A careful analysis of the PSPS-G9190126 ledger lends question as to whether the auditor actually documented account credits on December 31, 1999 as *debits*. (For example, ISDLS expended a total of \$3,334 on per diem for the national criminal justice seminar, originally allocating this sum to PSPS-G5190549. On December 31, 1999, ISDLS credited this sum (\$3,334) from PSPS-G519059 and reallocated it to PSPS-G9190126. The Regis Associates CPA concluded that ISDLS had erroneously allocated \$6,668 to PSPS-G5190549, indicating that she may have added the absolute value of the debit and credit ( $\$3,334 + \$3,334 = \$6,668$ ), instead of subtracting the credit from the debit ( $\$3,334 - \$3,334 = \$0$ ).
- g. Supporting Documentation: Please see **Attachment E**, which includes the PSPS-G519059 ledger, showing that (1) ISDLS expenses after the expiration date total \$371.78, and (2) ISDLS made journal entries on December 31, 1999 to reallocate the Cairo seminar expenses from PSPS-G5190549 to PSPS-G9190126; the PSPS-G9190126 ledger, showing that ISDLS overspent the grant by approximately \$29,000; and the final PSPS-G5190549 financial report generated by the former ISDLS financial officer, George Roque, indicating that all grant funds were expended pursuant to budgeted line items.

8. Grant # S-ECAPE-02-GR-046(CS) – Turkey
- a. Issue: (From page 6, 3<sup>rd</sup> paragraph): “...expenses recorded in the contract’s general ledger amounted to \$361,436.30, resulting in unexpended funds of \$18,395.70 that was not returned to the Department of State.”
  - b. Response: The funding period of the grant extends from 12/20/01 until 4/30/04, per the original grant and amendment A001, which was available in the grant file kept by ISDLS. During this period, revenues were \$379,832.00, while documented expenditures were \$375,937.80. According to these figures, our records show unexpended funds of \$3,894.20.
  - c. A careful analysis of our ledger has revealed an error made by an interim financial officer during the summer of 2004. First, Legal Reporter expenses totaling \$6,500.00 (for Professor Herman Schwartz’s development of hypothetical fact patterns for use by the Turkish delegation) on 4/27/2004 were erroneously allocated to the wrong grant. The correction has been made, and is reflected in **Attachment F**.
  - d. Second, ISDLS expended an additional \$10,374.12 on the Turkey Legal Reform Project in the two-month period following the conclusion of the funding period. All such costs incurred were administrative costs, i.e., salaries and related payroll taxes, or direct costs, i.e., telephone charges. (ISDLS incurred the telephone charges of \$2.16 in January, 2004, but paid them in May, 2004.) All costs incurred during this period were for the completion of administrative duties connected to the completion of ISDLS’ obligations to the USDOS under Article VI(b)(1) & (2) (the “Final Program” and “Financial” reports), which provides for a 90 day period from the end of the funding period in which the award recipient may complete its obligations under the award. ISDLS has included in the ledger the salaries, payroll taxes, and indirect costs incurred in the latter half of 2003 and all of 2004.
  - e. ISDLS records indicate that the organization spent \$6,479.72 in excess of total grant funds provided by S-ECAPE-02-GR-046(CS). The new balance is the product of previously unaccounted for Legal Reporter expenses, reasonable administrative costs incurred to complete obligations to the grantor, and an additional sum of indirect costs previously known but not entered into the ledger. As stated above, some indirect, as well as some administrative costs, were not included in the ledger due to an ongoing audit for 2003 and an ongoing reassembly of the 2004 financial statements.
  - f. Supporting Documentation: Please see **Attachment F**, which includes the ISDLS ledger for S-ECAPE-02-GR-046(CS).

## 9. Grant # S-ECAPE-02-GR-046 (CS) – Turkey

- a. Issue: (From page 7, last paragraph): “There were no invoices or other documentation to support expenses charged to Grant # S-ECAPE-02-GR-046 (CS) – Turkey.”
- b. Response: During the Review, ISDLS had temporarily misplaced its copy of the ECA Grant Agreement. (The Agreement is available for review.) However, ISDLS has retained all invoices and documentation supporting expenses covered by this grant at its office, and these documents were available for examination during the Review. It is unclear why the auditor drew the conclusion that “there were no invoices or other documentation to support expenses,” when ISDLS management advised that *only* the ECA Grant Agreement had been misplaced, whereas invoices and other documentation have always been available.

## 10. Grant # PSPS-G6190048 – India

- a. Issue: (From page 7, last paragraph): “There were no invoices or other documentation to support expenses charged to Grant # PSPS-G6190048 – India, and Grant # S-ECAPE-02-GR-046 (CS) – Turkey.”
- b. Response: In a February 7 or 8 discussion between the ISDLS financial officer and the auditor regarding the PSPS-G6190048 records, the financial officer raised the question of whether it would be reasonable to request documents (that were, in some cases, ten years old), which were contained in storage. Specifically, the issue was the existence of a possible statute of limitations that may apply to the exercise of inspection authority claimed by USDOS. (It was then advised that current regulations regarding the authority of USDOS to inspect a grantee’s records are limited to activities taking place within a reasonable time. Further, the USDOS request to inspect records must be timely with respect to the subject matter of inspection.) Underlying this conversation was the provision of information by Lateef Abassi in his email of 1/19/05. In his email, Mr. Abassi requested information dating back to 2003, but also included a general request for other information that may be required upon review of the other listed items. While ISDLS keeps all the 2001-2005 financial records from 2001-2005 in the office of the financial officer, older documentation is contained in storage (in the Executive Director’s closet, in the same building and on the same floor as the financial officer’s office, due to the limited storage capacity of the financial officer’s office) for practical reasons. The financial officer communicated to the auditor that while the records were in storage, they could be located and presented for examination. In response, the auditor explained that examination of the documents would not be necessary until a future date, during the testing phase of the audit. In preparation for the upcoming testing phase, the financial officer located the document in the storage closet, and the documents are now available for examination at any time.

Summary:

1. ISDLS does maintain schedules and documentation for loans payable (currently on a verbal basis, but will implement sound documentation systems to augment the verbal system), payroll, payroll tax payable, and accounts payable over the years.
2. ISDLS did develop an indirect cost rate. ISDLS has used an indirect cost rate of 24.5% prior to 2004, and is currently using a provisional indirect cost rate of 49%.
3. ISDLS' significant fundraising efforts allow the Institute to cover its own office expenses for nearly seven months without federal assistance.
4. ISDLS' programs rely on approximately 80 legal expert volunteers, only three of whom have ever received compensation for their work.
5. Grant # PEMA-0098 – Tanzania: The ISDLS ledger shows an unexpended balance of \$252.97.
6. Grant # PECS-1087 – Middle East: Amendment A003 altered the program budget. The amendment line items are consistent with total grant expenditures. ISDLS overspent the grant by \$2,192.18.
7. Grant # PSPS-G519059 – Egypt: The ISDLS ledger shows that expenses totaling \$371.78 were charged to the grant after the expiration date, not \$15,631.48.
8. Grant # S-ECAPE-02-GR-046(CS) – Turkey: ISDLS overspent the grant by \$6,479.72.
9. Grant # S-ECAPE-02-GR-046(CS) – Turkey: Invoices and other documentation have always been available for review.
10. Grant # PSPS-G6190048 – India: Invoices and other documentation have always been available for review.

I hope that this memorandum will be able to clarify some of the issues raised in the Review.

Regards,

Stephen Mayo  
Executive Director  
ISDLS

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