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July 10, 2017

Mr. Ben Cole  
Executive Director  
North Mississippi Rural Legal Services, Inc.  
5 County Road 1014, P.O. Box 767  
Oxford, MD 38655-0767

Dear Mr. Cole:

Enclosed is the Legal Services Corporation's Office of Inspector General's (OIG) final report for our audit of Selected Internal Controls at North Mississippi Rural Legal Services, Inc. Your comments are included in the final report as Appendix II.

The OIG considers your proposed actions to address Recommendations 1, 2 and 3 as responsive. The actions planned by grantee management to update its Accounting Manual and your oversight regarding preparation of sole source contracts should correct the issues identified in the report.

However, Recommendations 1 and 2 will remain open until the grantee has provided the OIG an updated Accounting Manual and obtained the required Board of Directors' approval for the new policies and procedures. Recommendation 3 is considered closed.

Please provide us with your response to close out the two open recommendations along with the revised Accounting Manual within six months of the date of this final report.

Sincerely,

Jeffrey E. Schanz  
Inspector General

Enclosure

cc: Legal Services Corporation  
Jim Sandman, President

Lynn Jennings, Vice President  
For Grants Management

North Mississippi Rural Legal Services, Inc.  
Hon. Willie James Perkins, Sr.  
Board Chairperson

Sent by E-mail to Board of Directors

Hon. J. Lane Greenlee  
Ms. Mattie Tucker  
Hon. Derrick T. Simmons  
Ms. Marry Hastings  
Hon. Solomon Curtis Osborne  
Mr. Robert Mayes  
Hon. Nebra Porter  
Ms. Katherine Weatherby  
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Hon. Gwendolyn Baptist-Rucker  
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Hon. Karen Peairs  
Mr. Robert Jamison

LEGAL SERVICES CORPORATION  
OFFICE OF INSPECTOR GENERAL

FINAL REPORT ON SELECTED INTERNAL  
CONTROLS

NORTH MISSISSIPPI RURAL LEGAL SERVICES, INC  
RNO 625040

Report No. AU 17-08

July 2017

[www.oig.lsc.gov](http://www.oig.lsc.gov)

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## INTRODUCTION

The Legal Services Corporation (LSC) Office of Inspector General (OIG) assessed the adequacy of selected internal controls in place at North Mississippi Rural Legal Services, Inc (NMRLS or grantee) related to specific grantee operations and oversight. Audit work was conducted at the grantee's administrative office in Oxford, MS and at LSC headquarters in Washington, DC.

In accordance with the Accounting Guide for LSC Recipients (2010 Edition) (Accounting Guide), Chapter 3, an LSC grantee "...is required to establish and maintain adequate accounting records and internal control procedures." The Accounting Guide defines internal control as follows:

[T]he process put in place, managed and maintained by the recipients' board of directors and management, which is designed to provide reasonable assurance of achieving the following objectives:

1. safeguarding of assets against unauthorized use or disposition;
2. reliability of financial information and reporting; and
3. compliance with regulations and laws that have a direct and material effect on the program.

Chapter 3 of the Accounting Guide further provides that each grantee "must rely... upon its own system of internal accounting controls and procedures to address these concerns" such as preventing defalcations and meeting the complete financial information needs of its management.

## BACKGROUND

North Mississippi Rural Legal Services, Inc (NMRLS) is a non-profit organization that provides free legal assistance in civil matters to persons in North Mississippi's 39-county area. NMRLS services consist of legal assistance and representation to the poor, elderly, and disabled needing help with matters such as family issues, taxes, bankruptcy, housing problems and elder care. NMRLS operates out of four branch offices located in Oxford (Administrative), West Point, Clarksdale and Greenville, Mississippi.

Audited financial statements for the year ended December 31, 2015 show the grantee received a total of \$2,479,710 in LSC and non-LSC funding. Approximately 70 percent or \$1,747,289 of the grantee's total support was provided by LSC.

## OBJECTIVE

The overall objective was to assess the adequacy of selected internal controls in place at the grantee as the controls related to specific grantee operations and oversight, including program expenditures and fiscal accountability. Specifically, the audit evaluated select financial and administrative areas and tested related controls to ensure that costs were adequately supported and allowed under both the LSC Act and LSC regulations.

## AUDIT FINDINGS

To accomplish the audit objective, the OIG reviewed and tested internal controls related to cash disbursements, credit cards, cost allocation, contracting, fixed assets, general ledger controls, derivative income, internal reporting and budgeting, and employee benefits and payroll. Many of the controls were adequately designed and properly implemented as they relate to specific grantee operations and oversight; however, some controls need to be strengthened and formalized in writing. Also, any revisions to the written policies contained in the updated accounting manual need to be adequately communicated to the staff. The OIG identified the following areas that need improvement.

### WRITTEN POLICIES AND PROCEDURES

Overall, the grantee's written policies and procedures in the areas of cash disbursements, credit cards, fixed assets, employee benefits, general ledger and financial controls and payroll properly described the controls and procedures followed by the grantee. The OIG determined that the practices appear adequate and in accordance with LSC *Fundamental Criteria*. However, the OIG believes the policies and procedures related to contracting, derivative income, cost allocation and budgeting need strengthening. The OIG's audit was based on the policies and procedures contained in the 2016 accounting manual. Nevertheless, we also reviewed the 2017 manual for those areas detailed above to determine whether there were any new policy updates. While the updated 2017 Accounting Manual contains some updated policies and procedures, the manual did not completely address the policy weaknesses identified by the OIG.

Section 3-4 of the Accounting Guide states each grantee must develop a written accounting manual that describes the specific procedures to be followed to comply with LSC's *Fundamental Criteria of an Accounting and Financial Reporting System (Fundamental Criteria)*.

Without detailed written procedures, there could be a lack of transparency and consistency in the application of the methodology. Written policies and procedures serve as a method to document the design of controls and communicate them to the staff.

For the policy weaknesses stated below, the grantee was generally unaware that more detail and consistency with LSC's Accounting Guide was needed.

## Contracting Policy

NMRLS' written policies and procedures relating to contracting need strengthening to be comparable to LSC's *Fundamental Criteria*. In general, the practices related to contracting appeared adequate, except that we noticed the grantee did not prepare sole source justification where required.

The grantee's Accounting Manual did not include policies and procedures relating to:

- sole source procurement;
- maintenance and filing of documentation;
- number of competitive bids required; and
- types of contracts.

The grantee's new 2017 Accounting Manual had updated policies and procedures for sole source procurements and maintenance of contract documentation which the OIG deemed adequate.

In addition, the grantee's Accounting Manual detailing the competitive bidding threshold differs from what is practiced by the grantee and needs to be updated. The grantee's Accounting Manual has set the limit for competitive bidding at \$5,000, however the Fiscal Manager stated that, in practice, the threshold triggering competition is \$2,500 which the OIG concludes was adequate. As such, the Accounting Manual needs to be updated.

## Derivative income Policy

The policies in NMRLS's Accounting Manual relating to derivative income were not comparable to the *Fundamental Criteria*. The accounting manual did not detail the types of derivative income such as interest income, court awarded attorney fees and rental income. The updated manual, approved by the Board on January 28, 2017, includes policies and procedures for court awarded fees, but still excludes the other types of derivative income. The grantee's methodology and practice on allocating derivative income appears reasonable, but they only received interest income during the period under audit, which they completely allocated to LSC.

## Cost Allocation

The cost allocation policy in the grantee's Accounting Manual did not match its current practice used in allocating indirect costs. The practice appears acceptable and in accordance with LSC's *Fundamental Criteria*, however, the written policy is missing the description detailing that in practice the allocation is performed twice a year, and that the Fiscal Manager establishes a budget for each grant detailing the indirect cost amount that can be charged to each grant. The policy also does not state the reasoning behind allocation of various indirect costs, such as the use of judgment calls or when the Fiscal Manager takes into consideration the fact that each grant has certain limits for indirect

costs based on factors such as Private Attorney Involvement cases closed or a matching dollar amount.

### Budgeting Policy

Budgeting policies and procedures in the grantee's Accounting Manual are too general, need to be more specific and are missing the following detailed elements:

- (1) budget formulation procedures;
- (2) timing of the budget process;
- (3) budgeting responsibilities; and
- (4) budget approval process.

The grantee's budgeting practice in place is adequate and in accordance with the LSC *Fundamental Criteria*. In fact, grantee management submitted adequate budget policies and procedures as part of its LSC application submission, which are in accordance with LSC's *Fundamental Criteria*, however, the written policies need to be updated in the Accounting Manual.

**Recommendation 1:** The Executive Director should establish written policies and procedures in the grantee's Accounting Manual for:

- the recording of derivative income; and
- the budgeting process;

and update written policies incorporating grantee practices for:

- the cost allocation process; and
- contracting (as identified above).

The written policies should describe in sufficient detail all processes and controls currently used by the grantee and be in accordance with LSC's Accounting Guide and *Fundamental Criteria*.

**Recommendation 2:** The Executive Director should train staff on all revisions and additions to the written policies detailed in the updated accounting manual to ensure that all new policies are being followed and used in practice.

## **CONTRACTING**

### Lack of Sole Source Justifications

The OIG judgmentally selected fourteen contracts to test. Five of those contracts did not have the required sole source justifications. Of the nine remaining contracts, two were properly documented with evidence of competition or sole source justification and seven

were below the threshold requiring competitive bidding or sole source documentation. While the OIG was on site, the NMRLS Network Administrator and the NMRLS Executive Director prepared the sole source justifications for each of the five contracts. NMRLS management was unaware of the requirement that sole source justifications must be prepared and maintained in the contract file. The OIG reviewed the newly prepared sole source justifications and determined that they adequately supported those contracts.

Section 3-5.16, Contracting, of the Accounting Guide states the process used for each contract action should be fully documented and the documentation maintained in a central file. In addition, documents to support the competition should be retained in the contract file. Any deviation from the approved contracting process should be fully documented, approved and maintained in the contract file.

Contracting is a high-risk area with potential for abuse. Since all contracts are not the same, competition for large contracts helps ensure the best value for the grantee and proper documentation helps ensure that an approved contract has followed all established procedures.

**Recommendation 3:** The Executive Director should ensure that for every contract awarded as sole sourced, a sole source justification is prepared in accordance with the grantee's written policies and updated accounting manual. The justification is to be prepared before the contract is executed and maintained in the contract file.

## **SUMMARY OF GRANTEE MANAGEMENT COMMENTS**

Grantee management agreed with all the findings in the report and accepted all three recommendations. NMRLS agreed to update their Accounting Manual and train their staff on the revisions, updates and additions. In addition, the Executive Director will provide oversight for all sole source awarded contracts and ensure that all documentation will be maintained in a contract file by the accounting department. Grantee management's formal comments can be found in Appendix II.

## **OIG EVALUATION OF GRANTEE MANAGEMENT COMMENTS**

The OIG considers the proposed actions to address Recommendations 1, 2 and 3 as responsive. The actions planned by the grantee management to revise and update its Accounting Manual and oversight by the Executive Director regarding preparation of sole source justifications should correct the issues identified in the report.

However, Recommendations 1 and 2 will remain open until the grantee has provided the OIG an updated Accounting Manual and obtained the required Board of Directors' approval for the new policies and procedures. Recommendation 3 is considered closed.

## SCOPE AND METHODOLOGY

To accomplish the audit objective, the OIG identified, reviewed, evaluated and tested internal controls related to the following activities:

- Cash Disbursements;
- Credit Cards;
- Contracting;
- Cost Allocation;
- Derivative Income;
- General Ledger and Financial Controls;
- Internal Management Reporting and Budgeting;
- Property and Equipment;
- Employee Benefits; and
- Payroll.

To obtain an understanding of the internal controls over the areas reviewed; grantee policies and procedures were reviewed including manuals, guidelines, memoranda and directives, setting forth current grantee practices. Grantee officials were interviewed to obtain an understanding of the internal control framework. Management and staff were interviewed as to their knowledge and understanding of the processes in place. To review and evaluate internal controls, the grantee's internal control system and processes were compared to the guidelines in the *Fundamental Criteria* contained in the LSC Accounting Guide. This review was limited in scope and not sufficient for expressing an opinion on the entire system of grantee internal controls over financial operations.

The OIG assessed the reliability of computer generated data the grantee provided by reviewing available supporting documentation for the entries selected for review, conducting interviews and making physical observations to determine data consistency and reasonableness. We determined the data were sufficiently reliable for the purposes of this report.

To test for the appropriateness of expenditures and the existence of adequate supporting documentation, disbursements from a judgmentally selected sample of employee and vendor files were reviewed. The sample consisted of 65 disbursements totaling \$139,608 and 19 credit card disbursements totaling \$2,411. The 84 disbursements sampled totaling \$142,017 represents approximately 13 percent of the grantee's total expenses of \$1,104,526 other than for payroll during the period January 1, 2016 to December 31, 2016.

To evaluate and test internal controls over contracting, fixed assets, internal management reporting and budgeting, cost allocation, general ledger and financial controls, employee benefits and payroll, we interviewed appropriate program personnel, examined related policies and procedures and selected specific transactions to review for adequacy.

Controls over derivative income were reviewed by examining current grantee practices and reviewing the written policies contained in the grantee's accounting manual, where applicable.

The on-site fieldwork was conducted from February 9 through February 17, 2017. Our work was conducted at the grantee's program administration office in Oxford, Mississippi and at LSC headquarters in Washington, DC. We reviewed documents pertaining primarily to the period January 1, 2015 through December 31, 2016.

This audit was conducted in accordance with generally accepted government auditing standards. Those standards require that the audit be planned and performed to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. The OIG believes the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

NORTH MISSISSIPPI RURAL LEGAL SERVICES



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June 30, 2017

Mr. John M. Seeba  
Assistant Inspector General for Audit  
Legal Services Corporation  
3333 K Street, NW, 3n1 Floor  
Washington, DC 20007

Dear Mr. Seeba:

We appreciate the opportunity to respond to the draft report on the results of the OIG audit of Selected Internal Controls at North Mississippi Rural Legal Services, Inc. (NMRLS). As noted in your letter and draft report dated May 4, 2017, many of NMRLS' internal controls were adequately designed and properly implemented as they relate to specific grantee operations and oversight; however, some controls need to be strengthened and formalized in writing. The Executive Director and Fiscal Manager are working with the Audit/Finance Committee to develop revised written policies and procedures for submission to the Board of Directors for approval and implementation. NMRLS' goal is to ensure that it is operating in compliance with all LSC requirements. We have taken into consideration all of the recommendations provided in your draft audit report and are updating our Accounting Manual to reflect these recommendations. NMRLS' response to specific items noted in your report is hereinafter set out.

WRITTEN POLICIES AND PROCEDURES

Derivative Income Policy

The NMRLS Accounting Manual, revised January 28, 2017 (the audit review period was January 1 2016 - December 31, 2016), as noted in your report, contains a policy on interest income. However, a policy covering court awarded attorney fees and rental income is not included.

Corrective Action

The NMRLS Accounting Manual will be amended to include written policies and procedures on recording derivative income, including court awarded attorney fees and rental income.

**Recommendation 1:**

**Cost Allocations and Budgeting Policy**

Corrective Action

NMRLS agrees its' Accounting Manual should be updated to establish written policies and procedures on recording of derivative income and the budgeting process. Additionally, updated written policies incorporating NMRLS practices for cost allocation and contracting will be added to the Accounting Manual. NMRLS' Accounting Manual is being revised to address these issues and will be submitted to the NMRLS governing board for adoption at the August 19, 2017 meeting. A copy of the Accounting Manual as revised and approved by the board will be provided to your office as documentation of compliance with the aforesaid recommendations.

**Recommendation 2:**

NMRLS agrees that staff should be trained on all revisions, updates and additions to written policies to ensure knowledge of and compliance with existing policies. NMRLS will implement this recommendation immediately and in the future the Executive Director will routinely provide training to staff on all changes to policies and procedures and ensure that such changes are timely implemented.

**Recommendation 3:**

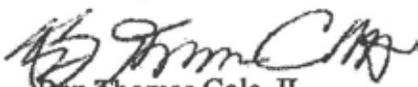
**Sole Source Contract Justifications**

Corrective Action

The Executive Director will provide oversight for all sole source awarded contracts to assure that all justifications are consistent with NMRLS written policies contained in the revised accounting manual. All sole source justifications will be prepared prior to the contract being entered and sole source justifications will be maintained by the accounting department in the contract file for future reference.

We appreciate the recommendations contained in your draft report. They are helpful to me and our staff in ensuring compliance with the requirements of the LSC Accounting Manual. We also thank you for the opportunity to respond to the draft report and look forward to taking the corrective action as notes above.

Sincerely,

  
Ben Thomas Cole, II  
Executive Director