Office of Inspector General
Legal Services Corporation

Inspector General
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March 27, 2019

Ms. Lori A. Molloy, Esq.
Executive Director
North Penn Legal Services, Inc.
559 Main Street, Suite 200
Bethlehem, PA 18018

Dear Ms. Molloy:

Enclosed is the Legal Services Corporation (LSC) Office of Inspector General's (OIG) final report for our audit on Selected Internal Controls at North Penn Legal Services, Inc. We included your comments in Appendix II of the final report.

The OIG considers the proposed actions to Recommendation 3 and 4 as fully responsive. These two recommendations are considered closed.

However, in regard to Recommendation 4, we encourage you to consider whether the $10,000 threshold for micro-purchases is appropriate. If you choose to do so, benchmarking thresholds at similar organizations might be useful. Additionally, LSC issued Procurement Policy Drafting 101 – Guidance for LSC Grantees, on June 17, 2016. It includes best practices for procurement which may be useful as you continue to evaluate related policies.

The OIG considers the proposed actions to Recommendation 1 as partially responsive. Recommendation 1 will remain open until the OIG is provided with a revised, Board approved procurement policy that addresses the LSC Accounting Guide, Section 3-5.16.

The OIG considers the proposed actions to Recommendations 2, and 5 through 16 as fully responsive. However, these thirteen recommendations will remain open until the proposed actions have been completed and supporting documentation and the Board approved policies pertaining to Recommendations 7, 11 and 12 are provided.

The OIG questioned costs totaling $1,067 of unallowable credit card transactions. Due to lack of sufficient accounting system documentation of expense allocations to determine the funding source, the full amount qualifies as unallowable costs. Pursuant to 45 CFR §1630.5(a)(2) and (3), this amount will be referred to LSC management for review and action.

Please send us your response to close out the fourteen recommendations open, along with the supporting documentations within six months of the date of this final report. We thank you and your staff for your cooperation and look forward to receiving your submission by September 23, 2019.

Sincerely,

Jeffrey E. Schanz
Inspector General

Enclosure

cc: Legal Services Corporation
Jim Sandman, President

Lynn Jennings,
Vice President for Grants Management

North Penn Legal Services, Inc.
Elizabeth Burton Nanovic, President
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Sent by E-mail to Board of Directors
Gary Neil Asteak
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LEGAL SERVICES CORPORATION

OFFICE OF INSPECTOR GENERAL

FINAL REPORT ON SELECTED INTERNAL CONTROLS

NORTH PENN LEGAL SERVICES, INC.

RNO 339070

Report No. AU 19-02

March 2019

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 Penn Legal Services, Inc. related to specific grantee operations and oversight. Audit work was conducted at the grantee's administrative office in Pittston, PA and 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 recipient's 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 Penn Legal Services Inc. (NPLS, or "grantee") is a nonprofit organization providing civil legal aid services to low-income residents of Northeastern Pennsylvania. NPLS has ten office locations in twenty counties. Its mission is to provide civil legal representation to low-income people and ensure equal access to justice for all.

NPLS receives financial assistance from various sources including the Legal Services Corporation (LSC) and the Pennsylvania Legal Aid Network (PLAN). According to the audited financial statement report for the fiscal year ending June 30, 2017, total funding for NPLS equaled $5,872,262. Of the total, PLAN provided 46 percent or $2,709,974 of funding. LSC provided funding in the amount of $1,898,554 or 32 percent. The remaining $1,263,734 or 22 percent of funding was provided by other sources.

OBJECTIVE

The overall objective was to assess the adequacy of the grantee's internal control environment. The audit evaluated select financial and operational areas and tested the related controls to ensure that costs were adequately supported and allowed under the LSC Act and LSC regulations.

AUDIT FINDINGS

To accomplish the audit objective, the OIG reviewed and tested internal controls related to disbursements, contracting, fixed assets, credit cards, cost allocation, derivative income, internal reporting and budgeting, general ledger and financial controls, employee benefits, and payroll. The controls were adequately designed and properly implemented as they relate to specific grantee operations and oversight over fixed assets, payroll and employee benefits. However, NPLS needs to strengthen practices and formalize in writing the internal controls in the areas of contracting, credit cards, disbursements, cost allocation, derivative income, general ledger and financial controls, management reporting and budgeting as detailed below:

Contracting

Inadequate Documentation and Approval Over Contracting

We interviewed staff and judgmentally selected six vendors for our contracting testwork based on the frequency of payments, high dollar amounts, and vendor names related to personal, consulting and service contracts, to determine whether the grantee's internal controls were adequate and complied with LSC regulations. The contracts reviewed were either competitively bid or sole-sourced. Sole-sourced contracts are contracts established without a competitive process and require justification that only one known source exists or that only a single vendor can fulfill the requirements.

The six contracts reviewed were staffing, IT (Information Technology) and janitorial service contracts totaling $75,343.55 during the audit period. The total amount charged to LSC was $21,416. We noted the discrepancies below and the related amount charged to LSC during the audit period:

- Five of six contracts totaling $11,956 had no contract agreements on file;
- None of the six contracts totaling $21,416 had documentation of the process used for each contract action on file;
- Five of six contracts totaling $11,956 had no documentation of approval on file;
- Three of six contracts totaling $16,872 had inadequate statements of work and lacked processes to verify deliverables were received; and

- None of the six contracts totaling $21,416 had documentation of competition or sole-source justification on file. Out of six contracts, five totaling $19,047 required competition and one totaling $2,368 was sole-sourced.

The former CFIO stated that they had followed contracting procedures such as obtaining quotes, contracts and approvals but they did not document the process, because they did not consider the contract amounts significant.

The LSC Accounting Guide 3-5.16 stipulates that the process used for each contract action should be fully documented and the documentation maintained in a central file. Documents to support competition should be retained and kept with contract files. The required approval level should be established for each contract type and dollar threshold, including when the board of directors should be notified or provide approval. Any deviation from the approved contracting process should be fully documented, approved, and maintained in the contract file. In addition, the statement of work should be sufficiently detailed so that the contract deliverables can be identified and monitored to ensure deliverables are completed. Improper contracting actions may subject the grantee to conflict of interest, impaired work, unreasonable prices and reduced value. Proper documentation helps ensure that approved contracts have followed all established procedures and competition helps ensure the best value for the grantees.

Appearance of Conflict of Interest Over a Sole-Sourced Contract

In addition, the sole-sourced contract for janitorial service totaling $8,535 appears to have a potential for conflict of interest. LSC was charged $2,368 during the audit period. An example of a conflict of interest is when a relationship could impair the employee's ability to act impartially and in the best interests of the grantee. We found that the service contractor is the spouse of the Systems Administrator. The grantee had no documentation of the selection, administration, and disclosure for consideration of conflicts of interest to management or the Board to document the recusal of the Systems Administrator in selection and administration of the contractor.

The grantee's Code of Conduct in Purchasing states that no officer, board member, employee, or agent shall participate in the selection or administration of a contractor if a real or apparent conflict of interest would be involved. However, the grantee does not require employees to disclose, in writing the material facts of any potential conflicts of interest to management or the Board. The former CFIO explained she did not consider the janitorial service as a contract and could not find a more reliable vendor. Therefore, there was no contract agreement established and none of the contracting procedures including consideration of conflict of interest were applied.

LSC OIG Fraud Alert 15-02 stipulates that employees should disclose, in writing, the material facts of any potential conflicts of interest that they may have with the program in any matter, typically to management or the Board, in order to determine whether they must recuse themselves from the matter or will be permitted to initiate or continue their involvement with the matter. A weak conflict of interest policy may subject the grantee to fraud, waste, and abuse.

Inadequate Contracting Policies

We reviewed the grantee's policies and procedures over contracting and found that they are mostly comparable to LSC's *Fundamental Criteria,* except they do not include dollar thresholds. The former CFIO explained that due to management oversight, they did not include dollar thresholds in the policy. She added that the Executive Director decides the dollar threshold for contracts.

The LSC Accounting Guide 3-5.16 stipulates that not all contracts are the same. Management should identify the contracting procedures for the various types of contracts, dollar thresholds, and competition requirements. Contracts that should receive additional oversight include consulting, personal services and sole-source. The type and dollar value of contracts that require competition should be included in policies of the grantee. Without established and written contracting procedures, contracts may be subject to fraud or waste due to inadequate policies.

The Executive Director should:

Recommendation 1: Ensure that all contracts have proper documentation on file including approvals, contract agreements, process and procedures for selection, competitive bids or sole-source justification, if not competitively bid, and adequate statements of work.

Recommendation 2: Consider the janitorial service contract for bids, document the selection, including contract agreements, approvals, and if sole-sourced, document the justification. Keep all related documentation on file.

Recommendation 3: Enhance the Code of Conduct in Purchasing policy to preclude even the appearance of conflict of interest and include in the policy a requirement to disclose in writing the material facts of any potential conflicts of interest to upper management or the Board.

Recommendation 4: Update the written policy over contracting to include a dollar threshold.

Credit Cards

LSC Unallowable Costs Over Credit Cards

We reviewed 85 individual credit card transactions totaling $20,518 from eight credit card statements. We judgmentally selected transactions based on factors including relatively large amounts, unfamiliar vendors, bank payments, dues, memberships, conferences and training.

We identified 13 credit card transactions totaling $1,067 that were considered unallowable by LSC regulations. These transactions included purchases of flowers, late fees, interest charges and an unallowable membership fee. The grantee did not use a funding code within the financial software to identify which funding source was charged to pay for the LSC unallowable costs. As a result, we were unable to confirm whether the unallowable costs were allocated and charged to funding sources other than LSC.

Due to the lack of sufficient accounting system documentation of expense allocations to determine the funding source, the full amount qualifies as an unallowable cost and will be questioned pursuant to 45 CFR §1630.5(a)(2) and (3). As such, $1,067 will be referred to LSC management for review and action.

The CFIO explained that they ensure that all LSC unallowable costs are reviewed and charged to other funding sources when they perform the monthly allocations in the Fund Shift Report, as described in the Cost Allocation section of the audit. However, the allocations were not yet performed for these costs at the time of our visit.

The Program Letter 17-1 and Title 45 CFR Part 1630 stipulates that expenditures by a recipient are allowable under the recipient's LSC grant only if the recipient can demonstrate that the cost was, among other things, reasonable and necessary for the performance of the grant and allocable to the grant. Also, the LSC Accounting Guide 2-5 stipulates that, "…accounting records should be maintained on an automated system." Each grantee should establish the system most appropriate to its needs and provide an adequate audit trail for all transactions. Failure to provide an audit trail for LSC unallowable costs increases the risk that improper allocations of LSC funds go undetected.

Lack of Documented Approvals Over Credit Cards

Our review of credit card transactions revealed 71 transactions lacking documented approvals required by the grantee's policy. Required purchase orders were not provided for 54 of the 71 transactions totaling $16,824. There were also missing expense reimbursement forms for 17 transactions totaling $2,462 related to travel and business meals. The former CFIO stated that she was moving the grantee to a paperless system and had not been consistently using purchase orders or expense forms for some time. Approvals were usually made verbally or by email. However, the CFIO had purged her emails in advance of her resignation from the grantee and prior to the OIG's visit.

The LSC Accounting Guide 3-5.4 stipulates that approval should be required at an appropriate level of management before a commitment of resources is made. The grantee's Financial Management Manual states that, a properly completed purchase order shall be required for each purchase decision, with the exception of office supplies and expense reimbursements. Failure to document and follow the purchase approval process may result in purchases made without the knowledge of appropriate management or at unacceptable prices or terms.

Inadequate Credit Card Policies

We reviewed the grantee's written policies and procedures over credit cards and found them mostly comparable to LSC's *Fundamental Criteria*. However, the grantee's policies lacked several components recommended in the LSC *Fundamental Criteria* as follows:

- There were no written policies and procedures for cash advances and ATM withdrawals.
- There was no written policy as to how soon receipts for credit card purchases should be submitted.

The former CFIO stated that effective controls were currently in place regarding these areas and the lack of documentation of these practices in the Financial Management Manual was an oversight.

The LSC Accounting Guide Appendix VII recommends that recipients should consider disallowing cash advances or ATM withdrawals as a matter of program policy and ensure a written policy exists as to how soon receipts should be submitted. A lack of written policies describing the permissible usage of credit cards may cause confusion in times of employee turnover, as new staff may not be fully aware of undocumented practices. This could lead to inappropriate credit card usage. Lack of a specific deadline for receipt submission increases the risk of undetected impermissible transactions and may lead to late payments, late fees and interest charges.

No Credit Card User Acknowledgement Agreement

The grantee did not establish a credit card user acknowledgement agreement. A signed credit card user acknowledgement agreement is a form established for an authorized card user to accept and abide by the grantee's policies and procedures governing the usage of credit cards. The former CFIO stated she did not know a credit card acknowledgement form was needed.

The LSC Accounting Guide Appendix VII recommends that recipients should consider including a form that contains the grantee's credit card policies for employees to review and sign. The lack of an acknowledgement agreement for credit card users may result in confusion over the initiation, approval, and use of credit cards. A signed acknowledgement demonstrates that authorized card holders have not only read the credit card policies but are also responsible for knowing and adhering to the policies.

The Executive Director should:

Recommendation 5: Ensure that LSC unallowable costs are charged to funding sources other than LSC and reflected within the financial software to provide an audit trail.

Recommendation 6: Ensure that the required approvals are documented and retained in file and update the policies and procedures to reflect the current practices related to the new paperless system.

Recommendation 7: Update the NPLS Financial Management Manual to include policies and procedures governing the permissible use of ATM withdrawals and cash advances. The Financial Management Manual should also be updated to specify when receipts for credit card purchases should be submitted to financial staff.

Recommendation 8: Require a signed acknowledgement agreement for each authorized credit card user. The agreement should include repayment terms and conditions for personal use or misuse of the card and be documented in file.

Disbursements

Lack of Documented Approvals Over Disbursements

We reviewed and tested 85 disbursements comprised of 122 individual transactions totaling $886,289. We judgmentally selected transactions for disbursements based on factors including relatively large amounts, unfamiliar vendors, employee reimbursements, bank payments, dues and memberships, conferences and training and contract services.

As a result, we found that all disbursement transactions reviewed were LSC allowable and adequately supported with receipts and invoices. However, 77 of the 122 individual disbursement transactions totaling $127,286 had no approvals documented in file. In our interview with the former CFIO we found that they were no longer using the purchase order system. As part of the new process, the accounting assistant scans and uploads invoices into the new paperless system. The former CFIO then reviewed and approved the invoices within the new paperless system prior to disbursement. However, this paperless system does not provide a record of approvals. The former CFIO explained that the new paperless system has some limitations and approvals were made verbally or by e-mail, but she had purged her e-mails before we began fieldwork, in advance of her departure from NPLS.

The LSC Accounting Guide 3-5.4 stipulates that, approval should be required at an appropriate level of management before a commitment of resources is made. The grantee's Financial Management Manual states that, a properly completed purchase order shall be required for each purchase decision, with the exception of office supplies and expense reimbursements. Failure to document and follow the purchase approval process may result in purchases made without the knowledge of appropriate management or at unacceptable prices or terms.

The Executive Director should:

Recommendation 9: Ensure that the required approvals are documented and retained in file and update the policies and procedures to reflect the current practices related to the new paperless system.

Cost Allocation

Financial Software Does Not Provide Audit Trail

We reviewed the grantee's allocation procedures to test whether the allocation formula and methodology were fair, consistent, and distributed in an equitable manner. We judgmentally selected allocations of personnel and non-personnel costs performed within the audit period reviewed.

Our testwork revealed that the grantee performs allocations outside of the financial software using an ad hoc spreadsheet, once a year, at year end. Per the former CFIO, NPLS follows the allocation formula established by Pennsylvania Legal Aid Network (PLAN). The ad hoc allocation spreadsheet is referred to as Plan's Fund Shift Report. The grantee's allocation formula and methodology performed within the Fund Shift Report appear to be reasonable and equitably distributed.

However, the grantee was not using their fund accounting software to its full capabilities. In particular, there were no allocation journal entries recorded within the financial software. As a result, we were unable to trace a sample of transactions within the financial software to determine whether:

- The application is performing the cost allocation in direct alignment of the grantee's allocation methodology and formula.
- Indirect costs are correctly accounted for within the financial software.

The former CFIO explained that NPLS has over 50 funding sources and does not have enough staff to perform journal entries for allocations every month.

The LSC Accounting Guide 2-5 stipulates that accounting records should be maintained on an automated system. Each grantee should establish the system most appropriate to its needs and provide an adequate audit trail for all transactions. Also, the LSC Accounting Guide 3-5.8 stipulates that general ledger design should accommodate fund accounting or cost center accounting and other financial requirements with the most expedient procedures in the circumstances.

The failure to fully incorporate fund accounting into the grantee's accounting software may result in an inability to document compliance with LSC regulations and federal requirements. The reliability of management and cost allocation reports generated from sources other than the general ledger can be significantly impaired and the actual preparation significantly more cumbersome.

Inadequate Policies Over LSC Unallowable Costs

We reviewed the grantee's written policies and procedures over cost allocation and found them mostly comparable to LSC's *Fundamental Criteria*, except they do not include procedures for allocating LSC unallowable costs. The former CFIO explained it is their practice not to charge or reimburse LSC unallowable costs. The former CFIO added that procedures for allocating LSC unallowable costs were not included in the Financial Management Manual due to an oversight.

LSC's Program Letter 17-1 stipulates that recipients should confirm that policies and procedures are in place to ensure LSC funds are only used for costs that are reasonable and necessary for the performance of the grant or contract. Lack of written procedures for allocating LSC unallowable costs may result in a violation of LSC rules and regulations.

The Executive Director should:

Recommendation 10: Ensure the accounting system is being fully utilized to provide an audit trail for all transactions so costs can be accounted for and traceable within the financial software.

Recommendation 11: Update written policy to include specific procedures the administration and allocation of LSC unallowable costs.

Derivative Income

Financial Software Does Not Provide Audit Trail

We reviewed the grantee's policies over derivative income and its allocation procedures. As a result, we found the policies over derivative income comparable to LSC's *Fundamental Criteria*. The grantee's derivative income is comprised of interest income totaling $1,277 from January 1, 2017 to March 31, 2018. The grantee also received one attorneys' fee totaling $500 from January 1, 2017 to March 31, 2018.

Our testwork revealed that the allocation of derivative income and attorneys' fee was performed in accordance to the grantee's policy within the ad hoc spreadsheet, Fund Shift Report. However, we found that the grantee does not perform allocation journal entries. As a result, we were unable to trace and verify whether the derivative income and attorneys' fee were allocated in the same proportion that the funds expended to support the representation within the financial software. The former CFIO explained that NPLS does not have enough staff to perform journal entries for allocations every month.

The LSC Accounting Guide 2-5 stipulates that accounting records should be maintained on an automated system. Each grantee should establish the system most appropriate to its needs and provide an adequate audit trail for all transactions. Also, 45 CFR § 1630.17(a), stipulates that derivative income resulting from an activity supported in whole or in part with LSC funds shall be allocated to the fund in which the recipient's LSC grant is recorded in the same portion that the same amount of LSC funds expended bears to the total amount expended by the recipient to support the activity. 45 CFR § 1609.4 (b) and the LSC Accounting Guide 2-2.6, stipulates that attorneys' fees received by a recipient for representation supported in whole or in part with LSC funds shall be allocated to the fund in which the recipient's LSC grant is recorded in the same proportion that the LSC funds expended bears to the total amount expended to support the representation.

The failure to provide an audit trail for allocating and recording derivative income and attorneys' fee with the financial software may result in an inability to document compliance with LSC regulations.

The Executive Director should:

Recommendation 12: Ensure the accounting system is being fully utilized to provide an audit trail for allocating and recording derivative income and attorneys' fee within the financial software.

General Ledger and Financial Controls

Untimely Bank Reconciliations

We reviewed the grantee's written policies and procedures over General Ledger and Financial Controls and found them comparable to LSC's *Fundamental Criteria*. To determine whether the grantee provided adequate internal controls and adhered to LSC regulations and guidelines, we non-statistically selected and reviewed six bank statements from the operating account and three bank statements from the payroll account with the corresponding reconciliation records from November 2017 to January 2018.

As a result, we found that the grantee performed untimely bank reconciliations and had inadequate documentation of the bank reconciliation review and approval process in both the operating and the payroll accounts. The former CFIO stated the reconciliation of the operating account is performed in two different ways; manually in a separate Excel spreadsheet and within the financial software. We found that the manual reconciliation record did not have a preparer's signature and date to reflect that reconciliations were performed on the 15th of each month. In addition, the bank reconciliation records performed within the financial software revealed that five of six bank reconciliations were 16 to 45 days late. The grantee was not able to provide records of bank reconciliations performed for the payroll account.

According to the former CFIO the Accounting Assistant responsible for performing bank reconciliations emailed the manual reconciliations for her review. However, the former CFIO was unable to provide e-mail records to support the timely performance of bank reconciliations. The new CFO, who started in July 2018, stated that bank reconciliations for the payroll account were not performed at all in fiscal year 2018. The new CFO also stated that he immediately remediated the weakness and performed an annual reconciliation on September 2018.

The LSC Accounting Guide Section 3-5.2 stipulates that bank statements shall be reconciled monthly to the general ledger. Also, the Financial Management Manual stipulates that the bank reconciliation process shall be completed by the 15th of the month after the end date of the bank statement. Proper reconciliation procedures will substantially increase the likelihood irregular disbursements and recording errors are discovered on a timely basis. The reconciliation procedure is a fundamental control technique and failure to use it may increase the likelihood of irregular disbursements. Additionally, recording errors may not be discovered.

Unresolved Outstanding Checks

The operating account bank reconciliation records from January 2018 revealed 15 checks totaling $2,990 that had been outstanding from prior years. Four totaling $1,468 had been outstanding since 2015, five totaling $802 had been outstanding since 2016 and six totaling $720 had been outstanding since 2017. We noted that the grantee's record of outstanding checks did not include the payee information and date of issuance to easily identify stale or uncashed checks. The Accounting Assistant explained they missed resolving the outstanding checks by mistake and that they should have been resolved or voided after six months of dormancy.

The LSC Accounting Guide Appendix VII recommends that checks outstanding for more than six months be investigated and resolved. Also, the Financial Management Manual stipulates that NPLS will write off checks of $1,000 or less that are more than 12 months old that have not cleared the agency's bank. For uncashed checks that are more than 12 months old and that exceed $1,000, contact will be made with the payee to resolve the issue. Not following procedures and inadequate documentation of outstanding checks may result in delaying a resolution. Also, potential fraud and errors may not be detected in a timely manner.

The Executive Director should:

Recommendation 13: Ensure that reconciliations for all bank accounts are completed every month and the records provide adequate information, including documentation of the persons performing and reviewing the reconciliations, and the date of each activity.

<u>Recommendation 14</u>: Ensure that checks outstanding for more than six months are investigated and resolved. The record of outstanding checks should include adequate documentation such as the date, number, payee and amount.

Management Reporting and Budgeting

<u>Inadequate Budget Projections</u>

We reviewed the grantee's policies and procedures over management reporting and budgeting and found them comparable to LSC's *Fundamental Criteria*. We non-statistically selected three monthly management reports and three quarterly budgeting reports within the fiscal year end of June 30, 2017. Our testwork revealed that the management reports appear to be adequate and consistently performed by the former CFIO. The grantee's budgeting process was also organized and approved by the Board of Directors.

However, our testwork revealed that budget projections presented to management were not prepared by cost center or funding source. Budget projections were prepared on a total program basis. Also, budget projections did not provide information on projected expenses remaining, projected total expenses for the year and projected variance over or under budget for the year. The CFO explained that projections for each funding source are monitored through Pennsylvania Legal Aid Network's (PLAN's) monthly allocation process within the Fund Shift report. He also added that members of PLAN, including NPLS appear to rely very heavily on the monthly Fund Shift report to monitor actual versus budget by funding source.

The <u>LSC Accounting Guide</u> 3-5.10 stipulates that the budget should be built from cost center and "rolled-up" to create a total budget. The format should coincide with the format of the management reports. In addition, the <u>LSC Accounting Guide</u> 3-5.11 stipulates that a report comparing actual expenses against projected expenditures should be made at least quarterly during the fiscal year. The report should include the following for each line item: (1) total budget; (2) actual expenditure to date; (3) projected expenses remaining; (4) projected total expenses for year (5) and projected variance over (under) budget. A consolidated report based on overall income and expenses lacks the detail necessary for proper analysis and control of cost center or program spending.

<u>Recommendation 15</u>: Ensure that the budget is built from cost center or funding source to create a total budget that coincides with the format of the management reports.

<u>Recommendation 16</u>: Ensure that the budget include projections for expenses remaining, total expenses for the year and variances over or under budget for the year on a quarterly basis.

GRANTEE MANAGEMENT COMMENTS

Grantee management agreed with the findings and 16 recommendations contained in the report. Grantee management stated the following:

- NPLS approved a new 1631 Procurement Policy. The policy requires that procurement records and files for purchases in excess of $10,000 shall include at a minimum the basis for vendor selection, justification for lack of competition when competitive bid offers are not obtained, and the basis for award cost or price. They understand the requirement for written contracts and include deliverables in the contract where appropriate.
- NPLS agreed that the files for janitorial services should document the basis for determining the reasonableness of the price and the selection of the service supplier. The policy requires that any conflicts of interest, real or apparent, must be disclosed to upper management and documented in the vendor file.
- NPLS updated the Procurement Policy which clarifies the Conflict of Interest Policy, expanding its applicability to all administrative team members in addition to the Board of Directors.
- NPLS updated the Procurement Policy to create thresholds. The updated policy defines "Micro purchases" as those less than $10,000, which may be awarded without competitive quotes if they consider the price reasonable.
- NPLS created a project class called "UNREST" for unallowable costs within the accounting software. Prior to allocation, all costs in the "UNREST" project class will be segregated and charged against Unrestricted Revenue sources.
- NPLS created an approval process, including a form for the Approval Manager available on the intranet site. This allows staff to submit requests for approvals to their manager automatically, with reminders issued for approvals when they are outstanding. All purchases are approved by the Chief Financial Officer prior to payment by NPLS and the approval is documented in the paperless system.
- NPLS expect to approve a new credit card policy at their next Board meeting.
- They expect to implement the use of a credit card acknowledgement form at their next Board meeting.
- NPLS implemented a new approval process where approvals are required to be documented in accordance with the procurement policy and part of the vendor file or individual procurement within the accounting software. All purchases are approved by the Chief Financial Officer prior to payment. The approvals are documented in the paperless system.
- NPLS indicated that the fund accounting system is appropriate to the needs and provides an adequate trail for all NPLS transactions. This includes any fiscal year-end journal entries necessary as a result of the Pennsylvania Legal Aid Network (PLAN) cost allocation spreadsheet. The Chief Financial Officer prepares the fiscal year end spreadsheet and reviewed by PLAN. External auditors review both

the fiscal year end worksheet and final journal entries affecting unrestricted and restricted fund balances in finalizing the audit of NPLS year-end financial statements.

- NPLS is working to update the cost allocation process and have created a project class called UNREST where unallowable costs are coded.
- NPLS drafted a new derivative income policy. The recording of rationale and support for the reclassification of derivative income in a journal entry within the accounting software shall be documented as part of the journal entry.
- NPLS indicated that all bank accounts are now reconciled monthly and reviewed by the Chief Financial Officer. All reconciliations now indicate the individual preparing or reviewing the reconciliation and date prepared or reviewed.
- NPLS indicated that all stale checks at June 30, 2018 were investigated and satisfactorily resolved by the Accounting Assistant with the approval of the Chief Financial Officer. Date, check number, payee and amount are now specified for all outstanding checks in the bank reconciliation.
- NPLS revised the budget for year-end June 30, 2019. The revised budget consolidates all locations as cost centers so that the support for the budget amount are used in the management reports.
- NPLS will ensure that commencing with the quarter ended March 31, 2019 report to management that all calendar year quarterly reports will include for each line item the actual expenditures year to date, projected expenses remaining, projected expenses for the year, total budget and projected variance.

The Grantee’s comments are included in Appendix II. Appendix II does not include the additional supporting documents provided by management.

OIG EVALUATION OF GRANTEE MANAGEMENT COMMENTS

The OIG considers the proposed actions for Recommendation 3 as fully responsive and closed. The grantee responded to Recommendation 3 and revised the procurement policy inclusive of the conflict of interest policy. The grantee expanded the applicability of conflict of interest policy to all administrative staff in addition to the Board of Directors.

The OIG considers the proposed actions for Recommendation 4 as fully responsive and closed. The grantee responded to Recommendation 4 by outlining changes to their Procurement Policy which include competition requirements for contracts based on dollar thresholds. The updated policy defines "micro purchases" as those less than $10,000; contracts for less than $10,000 may be awarded without competition. The OIG acknowledges that the thresholds for competition requirements may be set according to grantee management's discretion. However, the grantee should consider whether the threshold for micro-purchase is appropriate.

The Procurement Policy Drafting 101 – Guidance for LSC Grantees provides examples of the following competition requirements based on purchase cost:

- $0 - $3,000: Certification of Best Value or Price Comparison
- $3,000 - $10,000: Request for Quotes, Evaluation Sheet
- $10,000+: Request for Proposals, Evaluation Plan, Team and Sheet

The OIG requests that grantee management re-evaluate the threshold, evaluating best practices and guidance issued by LSC.

The OIG considers the proposed actions for Recommendations 1 as partially responsive. The grantee provided an updated procurement policy. However, the OIG finds the revised procurement policy not comparable with the LSC Accounting Guide in reference to board approval. The LSC Accounting Guide, Section 3-5.16, states that the required approval level should be established and include when the Board of Directors should be notified and give approval. The grantee's response to Recommendation 1 does not address requirements for documentation related to contract approvals.

Recommendations 1 will remain open until the OIG is provided with a revised, Board approved, procurement policy that includes when the Board of Directors should be notified and give approval.

The OIG considers the proposed actions to Recommendations 2, and 5 through 16 as fully responsive. The grantee management's planned actions to address the issues and update the policies and procedures pertaining to credit cards, derivative income and cost allocation should correct the issues identified in the report. However, these recommendations will remain open until the OIG is notified in writing that the supporting documentations are provided, and the proposed actions have been completed.

Recommendation 2 will remain open until the OIG is provided with supporting documentation related to janitorial services, such as the basis for determining reasonableness of price and the selection of the service provider.

Recommendation 5 will remain open until the OIG is provided with a report generated from the accounting software for the “UNREST” project class and an updated chart of accounts, if applicable.

Recommendation 6 will remain open until the OIG is provided with the new approval form for purchasing related to credit cards.

Recommendations 7 will remain open until the OIG is provided with the new, Board approved, credit card policy.

Recommendation 8 will remain open until the OIG is provided with a copy of the new credit card acknowledgement form.

Recommendation 9 will remain open until the OIG is provided with a report generated from the accounting software reflecting the purchasing or disbursement approvals.

Recommendation 10 will remain open until the OIG is provided with a record of the 2018 fiscal year end journal entries.

Recommendation 11 will remain open until the OIG is provided with the updated and Board approved cost allocation process.

Recommendation 12 will remain open until the OIG is provided with the Board approved derivative income policy.

Recommendation 13 will remain open until the OIG is provided with the operating and payroll bank account reconciliation report reflecting that reconciliations were performed monthly inclusive of preparer and reviewer information for fiscal year 2018.

Recommendation 14 will remain open until the OIG is provided with a supporting documentation related to outstanding checks reflecting that all stale checks at June 30, 2018 were investigated and resolved.

Recommendation 15 will remain open until the OIG is provided with the revised budget for year end June 30, 2019.

Recommendation 16 will remain open until the OIG is provided with the management report for quarter ended March 31, 2019.

The OIG questioned costs totaling $1,067 of unallowable credit card transactions. Due to lack of sufficient accounting system documentation of expense allocations to determine the funding source, the full amount qualifies as an unallowable cost. Pursuant to 45 CFR §1630.5(a)(2) and (3), this amount will be referred to LSC management for review and action.

APPENDIX I – 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/debit 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 areas listed above, we reviewed grantee policy and procedures, including manuals, guidelines, memoranda and directives, setting forth current grantee practices. Grantee officials were interviewed to obtain an understanding of the internal control framework. Grantee 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 of an Accounting and Financial Reporting System (Fundamental Criteria)* contained in the LSC Accounting Guide.

We 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 performed various tasks to determine reliability of data used during our fieldwork including vouching, recalculations, tracing, and comparing data. Based on steps performed, we determined that the computer processed data is reliable and sufficient for the purposes of this report in the areas reviewed, except for cost allocation. We were unable to determine if the allocations to each funding source are reliable because the grantee does not perform journal entries within the financial software.

To test for the appropriateness of expenditures and the existence of adequate supporting documentation, disbursements from a judgmentally selected sample of vendor files were reviewed. The sample consisted of 85 disbursements which included 122 transactions totaling $886,289. The sample represented approximately 49 percent of the $1,796,666 disbursed for expenses other than payroll during the period January 1, 2017 through March 31, 2018. To assess the appropriateness of expenditures, we reviewed invoices and vendor lists, then traced the expenditures to the general ledger. The appropriateness of those expenditures was evaluated based on the grant agreements, applicable laws and regulations and LSC policy guidance.

In addition to the disbursements, we sampled eight credit card statements consisting of 85 transactions totaling $20,518. We assessed the appropriateness of the expenditures and the existence of approvals and adequate supporting documentation.

To evaluate and test internal controls over the employee benefits, payroll, contracting, internal management reporting and budgeting, general ledger and financial controls, as well as derivative income, we interviewed appropriate program personnel, examined related policies and procedures as applicable and selected specific transactions to review for adequacy.

To evaluate the adequacy of the cost allocation process, we discussed the process with grantee management and requested, for review, the grantee's written cost allocation policies and procedures as required by the LSC Accounting Guide. We reviewed selected transactions to determine if the amounts allocated were in conformity with the documented allocation process and if the transactions were properly allocated in the ad hoc allocation spreadsheet.

Controls over purchasing, recording, inventorying, and disposing of property and equipment were reviewed by examining current grantee practices in comparison with LSC regulations and policies outlined in the LSC Accounting Guide.

The on-site fieldwork was conducted from May 14, 2018 through May 18, 2018. Our work was conducted at the grantee's administrative office in Pittston, PA and at LSC headquarters in Washington, DC. Documents reviewed pertained to the period January 1, 2017 through March 31, 2018.

The audit was conducted in accordance to 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 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 Penn LEGAL SERVICES

March 11, 2019

Rozanne Caruso
Assistant Inspector General for Audit
Office of the Inspector General
Legal Services Corporation
333 K Street NW, 3rd Floor
Washing, DC 20007-3558
By email to

Re: RNO 339070 Comments to the Draft Report on Selected Internal Controls

Dear Ms. Caruso:

We have reviewed the draft report and have taken actions to address a number of the items addressed in the report already. We have had certain new policies approved the Board and implemented other practices to address the issue. We are also preparing policies for Board approval this month and will continue to update our policies this year. We are also in the process of revising our fiscal handbook, to address issues observed in the audit and update them generally.

Below I have listed the recommendation and our comments. I am also noting where we have attached an approved policy and a proposed policy.

Recommendation 1 Ensure that all contracts have proper documentation on file including approvals, contract agreements, process and procedures for selection, competitive bids or sole-source justification, if not competitively bid, and adequate statements of work.

NPLS approved in a new 1631 Procurement Policy. The policy requires that procurement records and files for purchases in excess of $10,000 shall include the following at a minimum: (a) basis for contractor/vendor selection, (b) justification for lack of competition when competitive bids or offers are not obtained, and (c) basis for award cost or price. The Request for Quote form utilized for such procurements allows enough detail related statements of work.

NPLS understands the requirement for written contracts, and includes deliverables in the contract where appropriate.

Recommendation 2: Consider the janitorial service contract for bids, document the selection, including contract agreements, approvals, and if sole-sourced, document the justification. Keep all related documentation on file.

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NPLS agrees that files for janitorial services should document the basis for determining the reasonableness of the price and the selection of the service supplier. Such services, where less than $10,000 in annual costs, would be considered a micro-purchase and follow those procedures. The file will include basis for determining reasonableness of price. The policy requires that any conflicts of interest, real or apparent, must be disclosed to upper management and documented in the vendor file.

Recommendation 3: Enhance the Code of Conduct in purchasing policy to preclude even the appearance of conflict of interest and include in the policy a requirement to disclose in writing the material facts of any potential conflicts of interest to upper management or the Board.

NPLS has adopted a new Procurement Policy, and on page 1, it clarifies our Conflict of Interest Policy, expanding its applicability to all administrative team members in addition to the Board of Directors.

Recommendation 4: Update the written policy over contracting to include a dollar threshold.

NPLS updated the policy to create thresholds. The updated policy defines Micro purchases as those less than $10,000, which may be awarded w/o competitive quotes if NPLS consider price reasonable. Small purchases are those for between $10,000 to $250,000 and Sealed bids or competitive proposals apply to those that are less than $250,000.

Recommendation 5: Ensure that LSC unallowable costs are charged to funding sources other than LSC and reflected within the financial software to provide an audit trail.

Unallowable costs are coded to a project class called UNREST within the accounting software. Prior to allocation all costs in the UNREST project class will be segregated and charged against Unrestricted Revenue sources. See # 11 response

Recommendation 6: Ensure that the required approvals are documented and retained on file and update the policies and procedures to reflect the current practices related to the new paperless system.

Approvals shall be documented in accordance with the procurement policy and be part of the vendor file or individual procurement within our accounting software. NPLS created an approval process including a form for Approval Manager available on our intranet site. This allows staff to submit requests for approvals to their manager automatically, with reminders issued for approvals when they are outstanding.

All purchases are approved by the Chief Financial Officer prior to payment by North Penn Legal Services and the approval is documented in the paperless system.

Recommendation 7: Update the NPLS Financial Management Manual to include policies and procedures governing the permissible use of ATM withdrawals and cash advances. The

Financial Management Manual should also be updated to specify when receipts for credit card purchases should be submitted to financial staff.

NPLS expects to approve a new credit card policy, including an acknowledgement form, at our next Board meeting.

Recommendation 8: Require a signed acknowledgement agreement for each authorized credit card user. The agreement should include repayment terms and conditions for personal use or misuse of the card and be documented on file

NPLS expects to approve a new credit card policy, including an acknowledgement form, at our next Board meeting.

Recommendation 9: Ensure that the required approvals are documented and retained on file and update the policies and procedures to reflect the current practices related to the new paperless system.

Approvals are required to be documented in accordance with the procurement policy and be part of the vendor file or individual procurement within our accounting software. All purchases are approved by the Chief Financial Officer prior to payment by North Penn Legal Services and the approval is documented in the paperless system.

Recommendation 10: Ensure the accounting system is being fully utilized to provide an audit trail for all transactions so costs can be accounted for and traceable within the financial software.

The fund accounting system utilized by North Penn Legal Services is appropriate to our needs and provides an adequate audit trail for all transactions. This includes any fiscal year end journal entries necessary as a result of the Pennsylvania Legal Aid Network (PLAN) Cost Allocation spreadsheet. The fiscal year end worksheet is prepared by the Chief Financial Officer and reviewed by PLAN. External auditors review both the fiscal year end worksheet and final journal entries affecting unrestricted and restricted fund balances in finalizing the audit of North Penn's yearend financial statements.

Recommendation 11: Update written policy to include specific procedures the administration and allocation of LSC unallowable costs.

NPLS has been working to update the cost allocation process, which addresses this issue. In addition, please see our response to question 5 above.

Recommendation 12: Ensure the accounting system is being fully utilized to provide an audit trail for allocating and recording derivative income and attorneys' fee within the financial software.

NPLS has drafted a new Derivative Income policy. The recording of rationale and support for the reclassification of derivative income in a journal entry within the accounting software shall be documented as part of the journal entry.

Recommendation 13: Ensure that reconciliations for all bank accounts are completed every month and the records provide adequate information, including documentation of the persons performing and reviewing the reconciliations, and the date of each activity.

APPENDIX II

All bank accounts are reconciled monthly and reviewed by the Chief Financial Officer. All reconciliations indicate the individual preparing or reviewing the reconciliation and the date prepared or reviewed.

Recommendation 14: Ensure that checks outstanding for more than six months are investigated and resolved. The record of outstanding checks should include adequate documentation such as the date, number, payee and amount.

All stale checks at June 30, 2018 were investigated and satisfactorily resolved by the Accounting Assistant with approval of the Chief Financial Officer. Date, check number, payee and amount are specified for all outstanding checks in the bank reconciliation.

Recommendation 15: Ensure that the budget is built from cost center or funding source to create a total budget that coincides with the format of the management reports.

NPLS has implemented this recommendation. The revised budget for the year end June 30, 2019 consolidates all locations as cost centers so that the support for the budget amounts used in the management reports.

Recommendation 16: Ensure that the budget include projections for expenses remaining, total expenses for the year and variances over or under budget for the year on a quarterly basis.

NPLS will ensure that commencing with the quarter ended March 31, 2019 report to management all calendar year quarterly reports will include for each line item (1) actual expenditures year to date, (2) projected expenses remaining, (3) projected expenses for the year, (4) total budget and (5) projected variance.

Please contact me directly with any questions or concerns at 610-317-5306. Thank you for your consideration of these responses.

Sincerely,

Lori Molloy
Executive Director