Office of Inspector General
Legal Services Corporation

Inspector General
Jeffrey E. Schanz

3333 K Street, NW, 3rd Floor
Washington, DC 20007-3558
202.295.1660 (p) 202.337.6616 (f)
www.oig.lsc.gov

June 9, 2014

Mr. James H. Fry
Executive Director
Legal Services Alabama, Inc.
207 Montgomery St., Suite 1200
Montgomery, AL 36104-3537

Dear Mr. Fry:

Enclosed is the Office of Inspector General's (OIG) final report for our audit of Selected Internal Controls at Legal Services Alabama, Inc. (LSA). The OIG has reviewed your comments on the findings and recommendations in the draft report. Your comments are included in the final report as Appendix II.

The OIG considers the proposed actions to address Recommendation 1, 2, 3, 4, 6, 7, 8, 9 and 13 as responsive. However, all nine recommendations will remain open until the OIG is notified in writing that the proposed action has been completed or implemented.

The grantee's comments are not responsive to Recommendation 5, 10, 11 and 12. Grantee management's response only provides that the LSA Accounting Manual will be updated to address the issues. The responses do not include what procedures will be performed at this time to correct the specific issues.

The OIG is referring $29,915 in questioned costs to LSC Management for their determination. These costs involve expenditures of LSC funds that were identified as questioned costs, unallowable, unsupported or insufficiently supported.

We thank you and your staff for your cooperation and assistance.

Sincerely,

Jeffrey E. Schanz
Inspector General

Enclosure

cc: Legal Services Corporation
Jim Sandman, President
Lynn Jennings, Vice President for Grants Management

LEGAL SERVICES CORPORATION

OFFICE OF INSPECTOR GENERAL

FINAL REPORT ON SELECTED INTERNAL CONTROLS

LEGAL SERVICES OF ALABAMA, INC.

RNO 601037

.Report No. AU 14-05

June 2014

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 Legal Services of Alabama, Inc. (LSA or grantee) related to specific grantee operations and oversight. Audit work was conducted at the grantee's administrative office in Montgomery, Alabama and at LSC headquarters in Washington, DC.

In accordance with the Legal Services Corporation 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.

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 selected financial and administrative areas and tested the related controls to ensure that costs were adequately supported and allowed under the LSC Act and LSC regulations.

OVERALL EVALUATION

Our audit found a number of significant problems with the design and operation of some of the internal controls reviewed at LSA.

- The OIG tested 89 LSA disbursements expensed between January 2012 and September 2013. Of the disbursements tested, 35 disbursements (39 percent) totaling approximately $32,572 were unallowable, unsupported, insufficiently supported, or not approved.

- Policies and procedures were in place over the use of credit and debit cards including credit card usage, authorization, number of accounts, spending limits, payment procedures, and permissible charges. These policies were comparable with credit card guidance in LSC Accounting Guide. We noted that some credit card disbursements lacked adequate documentation.

- Duties were not properly segregated in the areas of maintenance of the vendor list, purchase order processes, invoice entries and vendor check disbursements.

- LSA had a questionable practice of accounting for matching funds. LSC funds were charged to a non-LSC grant for matching purposes even though the grant had an excess fund balance at the end of the grant period. It is the practice of the grantee to transfer these excess funds to the general unrestricted account.

- LSA does not have a system to reasonably track and match the costs and revenues associated with the space that the grantee leases out on two properties. Therefore, we were unable to determine if the rental income covered the rental expenses or if LSC funds were used to subsidize tenants.

- LSA needs to develop policies and procedures relating to soliciting and awarding contracts. In addition, controls over contracting need to be strengthened by using written contract agreements.

- Our review noted the grantee's fixed assets policy and procedures lacked certain components of the Property Acquisition and Management Manual (2001) (PAMM). In addition, the grantee's current practice for physical inventory was inadequate. Specifically, physical inventory results were not reconciled with property records and issues were not followed up on that were identified during a physical inventory. Also, the subsidiary record and the master inventory records did not have all information required by the LSC Accounting Guide, such as the identification number, location of item and check number used to purchase the item.

- The grantee's current practices involving cost allocation, client trust funds, derivative income and internal reporting and budgeting were generally in accordance with the LSC's *Fundamental Criteria*. However, the documented cost allocation procedures need to provide sufficient details fully describing how costs are allocated. The written policies and procedures relating to client trust funds need to be revised to include all components of the *Fundamental Criteria*. Policies and procedures for derivative income and internal reporting and budgeting need to be documented in the grantee's Accounting Manual.

- Finally, our tests confirmed that the amounts of salary advances requested by employees were adequately approved and did not exceed the net amount of two weeks pay as stipulated in the policies contained in the grantee's Accounting

Manual. Our tests also confirmed from accounting records that the amounts deducted towards the repayment of the salary advances were accurate.

AUDIT FINDINGS

DISBURSEMENTS

Of the 89 disbursements tested, 35 disbursements valued at approximately $32,572, were not allowed, not supported or inadequately supported, or not approved.

Our testing noted:

- 10 disbursements were unallowable;
- 5 that were unsupported;
- 15 that were insufficiently supported; and
- 5 that were not approved.

Ensuring that costs are allowable, maintaining adequate supporting documentation for expenditures and approving disbursements appropriately helps to ensure that funds are only used for authorized purposes.

LSC Regulation 45 CFR Part 1630, Costs Standards and Procedures, among other requirements, provide that expenditures by a grantee be reasonable and necessary for the performance of the grant or contract and adequately documented. The *Fundamental Criteria* also states that disbursements require adequate documentation supporting the reason for each disbursement contained in the files.

LSC Regulation 45 CFR Part 1627, Subgrants and Membership Fees or Dues, provide that LSC funds may not be used to pay membership fees or dues to any private or nonprofit organization, whether on behalf of a recipient or individual, unless mandated by a governmental organization to engage in a profession.

Unallowable Costs

LSC funds were used to pay for 10 disbursements, totaling approximately $3,462[1], that were unallowable.

- Five disbursements totaling $1,655[2] to pay membership dues to organizations in violation of 45 CFR §1627.4;
- One disbursement totaling $700, an overpayment for conference registration;

[1] The amount has been revised from the draft report based upon an additional review of supporting documentation. The amount increased by $405.

[2] *Ibid.*

- One payment totaling $817.08 (questioned amount totals $408.54) to pay for a training class held on a cruise ship[3];
- One disbursement totaling $429.82 to purchase flowers ($40.88) and food for a retirement party;
- One disbursement totaling $203.47 to pay for refreshments and travel for non-LSA staff; and
- One disbursement totaling $65 due to a per diem variance (out of state per diem paid versus in state).

Within the meaning of 45 CFR §1630.3, the OIG is questioning the cost of the ten disbursements totaling $3,462[4]. The questioned costs will be referred to LSC management for review and action.

<u>Unsupported Costs</u>

Supporting documentation was missing for five disbursements (representing 31 transactions) of LSC funds totaling approximately $6,894:

- One credit card disbursement totaling $2,553.10 to pay for travel and meals with no supporting documentation for any of the charges;
- One credit card disbursement totaling $630 to pay for an undeterminable charge;
- One credit card disbursement totaling $3,034.39 to pay conference and hotel costs with no supporting documentation for any of the charges;
- One disbursement totaling $352 to pay airline and parking costs with no supporting travel expense form; and
- One disbursement totaling $325 to pay membership dues with no supporting invoice.

Within the meaning of 45 CFR §1630.3, the OIG is questioning the cost of the four disbursements totaling $6,569[5]. The questioned costs will be referred to LSC management for review and action.

<u>Insufficiently Supported Costs</u>

Sufficient supporting documentation was not provided for fifteen disbursements totaling $15,179:

- Nine disbursements (representing 51 transactions) of LSC funds totaled $12,318.21. These mainly consisted of travel expenses paid for on credit cards.

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[3] The training was held on a cruise ship and the $817.08 was the price of training and cost of the cruise based on double occupancy. However, management indicated that only one person attended the training. Documents provided indicate another person was on the trip. It is not reasonable to pay for double occupancy if only one person was attending.
[4] See Footnote 1.
[5] One disbursement totaling $325 was both unallowable and unsupported. Therefore, we have only questioned the cost once, under unallowable costs.

Travel expense reports were not included with the credit card expenses, therefore not providing a purpose for the travel expenses.

- Six disbursements (representing 16 transactions) of LSC funds totaling \$2,861.11 for luncheons held by the grantee did not include a list of attendees.

Within the meaning of 45 CFR §1630.3, the OIG is questioning the cost of the 15 disbursements totaling \$15,179. The questioned costs will be referred to LSC management for review and action.

Improper Approval

Five disbursements totaling approximately \$7,036 were not approved in accordance with the grantee's approval procedures:

- Four disbursements totaling \$7,009.96 for credit card purchases exceeding \$1,000 did not have prior approval from the Executive Director as stipulated by the credit card policy.
- One disbursement totaling \$26.36 for a check requisition did not have supervisory approval.

These disbursements had supporting documentation and were allowed. Therefore we are not questioning these costs.

The Controller stated that she had only been with the grantee for three months and the unsupported and unapproved disbursements might have been due to oversight. In addition, the Controller stated that the unallowable disbursements, specifically membership dues, were due to grantee's lack of knowledge of LSC's Regulations.

Recommendations. The Executive Director should ensure that:

Recommendation 1: LSC funds are only used to pay allowable costs;

Recommendation 2: procedures are enforced that require disbursements to be accompanied by supporting documentation before payment; and

Recommendation 3: procedures are enforced to ensure invoices and credit card charges are properly approved prior to payment.

SEGREGATION OF DUTIES

LSA did not have segregation of duties in place for four major business processes. These processes were maintenance of the vendor list, purchase order preparation, invoice entries and vendor check disbursements. The accounting clerk who was responsible for maintaining the vendor master file also prepared purchase orders, processed invoices and check disbursements. A master vendor file is a listing in an accounting system of all approved vendors from whom goods or services are purchased. Generally, access to this file should be limited; and receiving and paying duties should be segregated, as a vendor's existence in the file allows purchase orders to be issued and checks to be cut to these vendors.

According to LSC's Accounting Guide Chapter 3-4

> Accounting duties should be segregated to ensure that no individual simultaneously has both physical control and record keeping responsibility for any asset, including, but not limited to, cash, client deposits, supplies and property. Duties must be segregated so that no individual can initiate, execute, and record a transaction without a second independent individual being involved in the process.

The Controller stated that the Accounting Clerk performs most of the functions due to the small size of the office. Without proper segregating of duties there is an increased possibility that misappropriation, concealment or theft could happen and not be discovered timely.

Recommendation 4: The Executive Director should develop compensating controls, such as independent monitoring, to assure that tasks handled by the same individual are processed consistently.

ACCOUNTING FOR MATCHING FUNDS

LSC funds were charged to a non-LSC grant for matching purposes even though the grant had a fund balance remaining at the end of the grant. According to grantee management, it was the practice of the grantee to transfer the difference between the amount of non-LSC funds provided by the funder and the amount of non-LSC funds charged to the grant to the grantee's unrestricted general fund. The amounts charged to LSC funds were not reduced when such a surplus existed. As a result, LSC funds were used to subsidize the grantee's unrestricted general fund. The grant was a subgrant from West Tennessee Legal Services, Inc. (WTLS) to implement the National Foreclosure Mitigation Counseling Program (NFMC) Round 6.

LSA received $98,100 in revenue for NFMC Round 6 which required a 20 percent match by the grantee. To comply with the matching requirement, $4,704.03 of LSC funds (equaling 4 percent of the grant amount) were charged to the grant. According to the grantee's records, the total cost of performing the grant was $91,710.34. Because the amount of non-LSC funds charged to the grant was less than the amount of funds provided by the funder (not including LSC's matching funds), it was the grantee's practice to transfer the difference, in this case $6,389.66, to the grantee's unrestricted general account. As a result, LSC funds were used in part to subsidize the grantee's general fund. In our opinion, the grantee should use all funds provided by the non-LSC funder before using LSC funds for matching purposes. We are therefore questioning $4,704.03 charged to LSC funds as not being reasonable and necessary for the performance of the non-LSC grant.

While LSC funds can be used for federal matching purposes when all LSC allowability standards are met, when LSC funds are used for matching purposes, we believe that the funds received from the non-LSC funder be used first before LSC funds are used for matching purposes.

The OIG is questioning a total of $4,704.03 for the grant described above. The questioned costs will be referred to LSC management for review and action.

Recommendation 5: The Executive Director should develop written policies and procedures to ensure that non-LSC funds be used before LSC funds are used for matching purposes.

RENTAL INCOME AND EXPENSE ALLOCATION

LSA does not have a system to reasonably track and match the costs and revenues associated with the space that the grantee leases out in two properties. As such, we were unable to determine if the rental income covered the rental expenses or if LSC funds were used to subsidize tenants. Also, LSA may not have the information necessary to comply with state and federal tax laws and regulations governing income generating properties.

LSA leased space out to tenants in two buildings owned by the grantee, one in Selma and the other in Birmingham. LSA occupies a portion of each building for its own use. LSA contracted with a realtor to manage both buildings. The realtor receives the lease payments and pays the building expenses including utilities, repairs, cleaning, landscaping, etc. At the end of every month, the realtor prepares a summary of the rental income and the building expenses and submits with the supporting documents to LSA. While the income can be associated with specific tenants, the expenses are not broken down by the amount allocated to LSA and the amount allocated to each tenant. As a result, LSA has no way of determining if the lease payments are covering the related expenses for each tenant. Also, LSA does not have the information required by taxing agencies to support the leasing activity.

The Executive Director stated that although he was aware that the buildings have a loss, the amount of loss was reduced within the past few years. In addition, he stated that the buildings often require repairs and renovations which account for most of the costs. While the expenses associated with the buildings may have exceeded the amount of rental income, without adequate accounting of the expenses associated with LSA occupied space and with each tenant, there would be no way of determining if the leases were at least covering their costs. Accurate accounting for both the revenue and expenses associated with each lease helps ensure that rent amounts charged are reasonable and that the information necessary to comply with applicable state and federal tax laws and regulations is available.

Recommendation 6: The Executive Director should develop a system to adequately track rental income and expenses associated with each tenant.

CONTRACTING

Written policies and procedures for contracts and consultants as required by LSC's *Fundamental Criteria* were not in place to describe and assign responsibilities for securing contracts. Some of the major items missing included the following:

- Specific procedures for various types of contracts;
- Competition requirements;
- Approval authorities and dollar thresholds for approvals;
- Documentation requirements to support contracting decisions such as sole source justifications and contract modifications; and
- Contract oversight responsibilities.

While written policies and procedures needed improvement, we also noted that the contracting practice was not entirely adequate. We noted that there were no formal contract agreements for janitorial services. The grantee stated that for janitorial services, they attempt to obtain the best quote. We noted monthly payments ranging from $240 to $396 per month to four janitorial vendors. For two of these vendors the payment amounts noted on the check register fluctuated; but without a formal contract, there was no way to validate the basis of the payments.

Without a formal contract, the statement of work along with other contract terms cannot be adequately communicated and monitored, which may obstruct management's ability to prevent or detect the risk of fraud, waste, and abuse.

Recommendations: The Executive Director should:

Recommendation 7: ensure written policies and procedures for contracting address all required areas contained in LSC's *Fundamental Criteria; and*

Recommendation 8: implement formal agreements describing cost and terms of work for all contracted jobs.

FIXED ASSETS

LSA fixed assets written policies and procedures were mostly comparable to LSC *Fundamental Criteria*. However, some policies need to be expanded and policies that were documented need to be followed.

Some requirements contained in Sections 3 and 4 of the LSC PAMM need to be documented in LSA's policies. Section 3 requires LSC's prior approval in obtaining bids for the acquisition of personal property over $10,000 when using LSC funds. It also requires documenting the reasons when competitive quotes are not obtained. Section 4 requires that the grantee seek LSC's prior approval to use LSC funds to acquire real property and for expenditures for capital improvements.

Grantee management was not following some of its own policies.

a. While a physical inventory was conducted as required by the *Fundamental Criteria*, the results of the physical inventory count were not reconciled to the property records. During the physical inventory process, LSA reconciled capitalized property and expensed inventory with the master inventory listing but there was no system in place to cross reference items on the master inventory listing and the property subsidiary record. As a result, LSA could not fully account for fixed asset purchases.

b. LSA count sheets had issues noted during the physical inventory that were not followed up. These issues included notes about capitalized or expensed property that required an asset tag, was disposed, or that the current location was unknown. We performed a test to determine whether property was tagged and whether property information was appropriately updated to the master inventory listing and noted four instances where property was not tagged and 10 instances where property information was not appropriately updated to the master inventory listing. Per discussion with the LSA Controller and Accounting Clerks, once the notations were made on the master inventory listing, no further action was taken to dispose of the issues.

c. The property subsidiary record did not contain three information fields required by the LSC Accounting Guide: identification number, location of item and check number used to purchase the item.

While LSA management agreed with the issues, the new Controller and accounting staff indicated that the former Controller was responsible for the process. Properly accounting for fixed assets enables the grantee to safeguard its assets, fully account for the assets purchased, and support reconciliations so that property asset balances are accurate.

Recommendations: The Executive Director should:

Recommendation 9: develop written policies and procedures that implement Sections 3 and 4 of the LSC Property Acquisition and Management Manual (2001);

Recommendation 10: ensure that the results of physical inventory counts are reconciled with property subsidiary records so as to address any differences between quantities determined by the inventory and those shown in the accounting records;

Recommendation 11: improve the physical inventory count process to ensure that all issues identified during physical inventory count are resolved timely;

Recommendation 12: update the property records to include all fields required by LSC *Fundamental Criteria*.

WRITTEN POLICIES

Operating practices for some areas reviewed were not documented in the grantee's Accounting Manual to comply with the *Fundamental Criteria* contained in the LSC Accounting Guide. The LSA Accounting Manual documents the policies and procedures to be followed by LSA staff in meeting the objectives and criteria of LSC and its other funding sources. The grantee's current practices in use involving cost allocation, client trust funds, derivative income and management reporting and budgeting generally conformed to the *Fundamental Criteria*, but these practices need to be fully documented.

The cost allocation process appears to be reasonable as direct expenses are allocated to the funding source that benefited from the expense and indirect costs are allocated based on a time study percentage. However, the written procedures did not fully describe the process as practiced by the grantee. The procedures should provide sufficient details, as required by the LSC Accounting Guide, fully describing how costs are allocated.

The grantee appeared to have adequate internal controls relating to client trust receipts, disbursements and ledger maintenance. However, client trust fund policies did not include all necessary requirements of LSC's *Fundamental Criteria*. The written policies did not include procedures for updating the general ledger for the client trust fund account and reconciling the client trust fund bank account to the client trust fund general ledger account.

The grantee received derivative income in the form of rent, investment interest, attorneys' fees and other miscellaneous income. Although the grantee did not have documented policies for derivative income, they had a practice of allocating 100 percent of the interest and rent to LSC while attorneys' fees were allocated based on the hours spent on the case and funding.

The grantee's budget process including creation and submission of monthly reports appears reasonable and is in conformity with the *Fundamental Criteria.* However, the grantee did not fully document its management report preparation policies, procedures, and responsibilities in its Accounting Manual.

In establishing an adequate internal control structure, each grantee must develop a written accounting manual that describes the specific procedures to be followed by the grantee in complying with the *Fundamental Criteria* contained in the LSC Accounting Guide.

Without adequate written policies and procedures in place, transactions may be initiated and recorded that violate management intentions, or possibly laws or grant restrictions. Written policies and procedures also serve as a method to document the design of controls and to communicate the controls to the staff.

Recommendation 13: The Executive Director should document policies for cost allocation, client trust funds, derivative income and management reporting to include all areas required by the LSC *Fundamental Criteria*.

SUMMARY OF GRANTEE MANAGEMENT COMMENTS

Grantee management agreed with the findings and recommendations contained in the report. Grantee management stated its Accounting Manual will be updated over the next twelve months to include written policies and procedures in accordance with the LSC Accounting Manual to address all of the issues raised in the report.

The Executive Director has changed supervision of the Accounting Department to the Director of Operations effective May 22, 2014. In regard to questioned costs, the Director of Operations will coordinate with members of the OIG audit team to identify and resolve the questioned disbursements. Those expenses that were unallowable will be reclassified.

In addition to the Accounting Manual update:

- Management will conduct training for credit cardholders and accounting personnel to ensure the credit and debit card procedures are followed to ensure the need for adequate supporting documentation;
- The Director of Operations is conducting an internal control and segregation review and will ensure that duties are properly segregated;
- Management will conduct a review of vendors to ascertain the status of contracts and/or to obtain written contracts for service; and
- Management is working with their Property Manager to develop a system to track and match the costs and revenues associated with space that LSA leases.

Management's formal comments can be found in Appendix II.

OIG EVALUATION OF GRANTEE COMMENTS

The OIG considers grantee management's actions planned to address Recommendation 1, 2, 3, 4, 6, 7, 8, 9 and 13 as responsive to the findings and recommendations contained in the report. The actions planned by grantee management to address the issues and revise and update its Accounting Manual should correct the issues identified in the report. The OIG considers all nine recommendations open until such time as written notification is received by OIG that all agreed actions have been taken and implemented by the grantee.

The grantee's comments are not responsive to Recommendation 5, 10, 11 and 12. Grantee management's response only provides that the LSA Accounting Manual will be updated to address the issues. The responses do not address what procedures will be performed at this time to correct the specific issues.

The OIG has coordinated with grantee management and provided them supporting documentation for the questioned costs identified on the report.

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;
- Cost Allocation;
- Contracting;
- Credit cards;
- Property and Equipment;
- Internal Management Reporting and Budgeting; and
- Salary Advances.

In addition we reviewed controls over derivative income and client trust fund accounting. Controls over derivative income were reviewed to determine whether income was properly recorded and allocated. Controls over client trust fund accounting were reviewed but not tested.

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, and 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. This review was limited in scope and was not sufficient for expressing an opinion on the entire system of grantee internal controls over financial operations.

We assessed the reliability of computer generated data provided by the grantee by reviewing source documentation for the entries selected for review. 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 was taken from the period January 1, 2012 through September 30, 2013, and represented approximately 6 percent of the $4,098,561 disbursed for expenses other than payroll and consisted of 89 transactions totaling $258,907. To assess the appropriateness of expenditures, we reviewed invoices, vendor lists, and traced the expenditures to the general ledger. The appropriateness of those expenditures was evaluated on the basis of the grant agreements, applicable laws and regulations, and LSC policy guidance.

To evaluate and test internal controls over the contracting process, credit card use, internal management reporting and budgeting, and property and equipment, we interviewed appropriate program personnel, examined related policies and procedures, and selected specific transactions to review for adequacy.

Controls over salary advances were reviewed by examining the personnel policies and practices, and by testing a judgmentally selected sample of employee reimbursements as part of the disbursements testing. To assess the salary advance process, we reviewed salary advance requests for appropriate approvals and verified that the amounts requested did not exceed the net amount of 2 weeks pay as stipulated in the policies contained in the grantee's Employee Handbook. We also reviewed accounting records showing the amount paid in advance and individual pay statements showing the amounts deducted towards the repayment of the salary advance.

To evaluate the adequacy of the cost allocation process, we discussed the cost allocation process for 2012 with grantee management and requested, for review, the grantee's written cost allocation policies and procedures as required by the LSC Accounting Guide. We recalculated the cost allocation amounts for 2012 using the information provided by the grantee.

Controls over derivative income were reviewed by examining current grantee practices and reviewing the written policies contained in the grantee's Accounting Manual. To evaluate controls over client trust fund accounting, we interviewed appropriate program personnel and examined related policies and procedures.

The on-site fieldwork was conducted from October 16 through October 24, 2013. Our work was conducted at the grantee's central administrative office in Montgomery, Alabama and at LSC headquarters in Washington, DC. Documents reviewed pertained to the period January 1, 2012 through September 30, 2013.

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 that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

APPENDIX II

LEGAL SERVICES
ALABAMA

May 23, 2014

Mr. John M. Seeba
Assistant Inspector General for Audit
Office of the Inspector General
Legal Services Corporation
3333 K Street NW, 3rd Floor
Washington, DC 20007-3558

RE: Response to Draft Report on Selected Internal Controls –RNO 601037
RNO AU XX-XX

Dear Mr. Seeba:

I am in receipt of the draft report on your audit of Selected Internal Controls at Legal Services Alabama dated April 15, 2014. I appreciate the efforts of your staff on this project and the professional manner in which the audit was conducted. Thank you for this opportunity to continue to improve our internal controls and fiscal accountability while we continue to serve Alabama's low-income community. I am providing remarks to the report's recommendations and am including a corrective action plan to address the issues and findings raised during the audit.

We are planning to revise and update our entire accounting guide over the next twelve months. I changed the supervision of our accounting department to our Director of Operations effective May 22, 2014. We will consult the LSC Accounting Guide to ensure the Fundamental Criteria are included in our Accounting Manual. The updated LSA Accounting Manual will include written policies and procedures to address all of the issues raised in your report, specifically disbursements, segregation of duties, accounting for matching funds, rental income and expense allocation, contracting, fixed assets, cost allocation, client trust funds, derivative income, management reporting and budgeting. Our Director of Operations will work with your audit team to identify and resolve the questioned costs identified in your audit report.

Once the revised Accounting Manual has been completed and approved, I will forward to you an electronic copy.

LSA agrees with Recommendation 1 that the Executive Director should ensure that LSC funds are only used to pay allowable costs.

LSA agrees with Recommendation 2 that the Executive Director should ensure procedures are enforced that require disbursements to be accompanied by supporting documentation before payment.

LSA agrees with Recommendation 3 that the Executive Director should ensure procedures are enforced to ensure invoices and credit card charges are properly approved prior to payment.

LSA agrees with Recommendation 4 that the Executive Director should develop compensating controls, such as independent monitoring, to assure that tasks handled by the same individual are processed consistently.

LSA agrees with Recommendation 5 that the Executive Director should develop written policies and procedures to ensure that non-LSC funds be used before LSC funds are used for matching purposes.

LSA agrees with Recommendation 6 that the Executive Director should develop a system to adequately track rental income and expenses associated with each tenant.

LSA agrees with Recommendation 7 that the Executive Director should ensure written policies and procedures for contracting address all required areas contained in LSC's Fundamental Criteria.

LSA agrees with Recommendation 8 that the Executive Director should implement formal agreements describing cost and terms of work for all contracted jobs.

LSA agrees with Recommendation 9 that the Executive Director should develop written policies and procedures that implement Sections 3 and 4 of the LSC Property Acquisition and Management Manual (2001).

LSA agrees with Recommendation 10 that the Executive Director should ensure that the results of physical inventory counts are reconciled with property subsidiary records so as to address any differences between quantities determined by the inventory and those shown in the accounting records.

LSA agrees with Recommendation 11 that the Executive Director should improve the physical inventory count process to ensure that all issues identified during physical inventory counts are resolved timely.

LSA agrees with Recommendation 12 that the Executive Director should update the property records to include all fields required by LSC Fundamental Criteria.

LSA agrees with Recommendation 13 that the Executive Director should document policies for cost allocation, client trust funds, derivative income and management reporting to include all areas required by the LSC Fundamental Criteria.

Again, thank you for the opportunity to provide comments to the audit report and to improve our internal controls and fiscal accountability. Should you have any questions or require additional information, please call me at (334) 223-5120.

Sincerely,

James H. Fry

James H. Fry
Executive Director

JF/eh

Encl.

lsc oig may 23 2014

Legal Services Alabama Corrective Action Plan RNO 601037
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Findings

Finding 1. The OIG rested 89 LSA disbursements expended between January 2012 and September 2013. Of the disbursements tested, 35 disbursements (39 percent) totaling approximately $32,672 were unallowable, unsupported, insufficiently supported, or not approved.

Corrective Action Plan: The Director of Operations will coordinate with members of the LSC OIG audit team to identify and resolve the questioned invoices. Those invoices and/or expenses that were unallowable will be reclassified.
Estimated Completion Date: June 30, 2014
Office of Primary Responsibility: Director of Operations

Finding 2. Policies and procedures were in place over the use of credit and debit cards including credit card usage, authorization, number of accounts, spending limits, payment procedures, and permissible charges. These policies were comparable with credit card guidance in LSC Accounting Guide. We noted that some credit card disbursements lacked adequate documentation.

Corrective Action Plan: LSA will conduct training for cardholders and accounting personnel to ensure the credit and debit card procedures are followed to ensure the need for adequate supporting documentation.
Estimated Completion Date: July 31, 2014
Office of Primary Responsibility: Director of Operations

Finding 3. Duties were not properly segregated in the areas of maintenance of vendor list, purchase order processes, invoice entries and vendor check disbursements.

Corrective Action Plan: The Director of Operations, having assumed supervision of the LSA Accounting Department effective May 22, 2014 is conducting an internal control and segregation review and will ensure that duties are properly segregated.
Estimated Completion Date: June 15, 2014
Office of Primary Responsibility: Director of Operations

Finding 4. LSA had a questionable practice of accounting for matching funds. LSC funds were charged to a non-LSC grant for matching purposes even though the grant had an excess fund balance at the end of the grant period.

Corrective Action Plan: LSA will review and update the LSA Accounting Manual to address the matching funds and the issue raised during the LSC OIG audit regarding the use of LSC funds for matching purposes. A copy of the updated LSA Accounting Manual will be provided to the LSC OIG upon completion.
Estimated Completion Date: December 31, 2014
Office of Primary Responsibility: Director of Operations

Finding 5. LSA does not have a system to reasonably track and match the costs and revenues associated with the space that the grantee leases out on two properties. Therefore, we were unable to determine if the rental income covered the rental expenses of if LSC funds were used to subsidize tenants.

Corrective Action Plan: LSA is working with our Property Manager to develop a system to track and match the costs and revenues associated with space that LSA leases. A copy of the updated LSA Accounting Manual will be provided to the LSC OIG upon completion.
Estimated Completion Date: June 30, 2014 – Develop system for tracking and matching costs and revenues of rental space for lessees.
Estimated Completion Date: No later than December 31, 2014 Update of LSA Accounting Manual
Office of Primary Responsibility: Director of Operations

Finding 6. LSA needs to develop policies and procedures relating to soliciting and awarding contracts. In addition, controls over contracting need to be strengthened by using written contract agreements.

Corrective Action Plan: LSA will develop written policies and procedures relating to the solicitation and awarding of contracts in accordance with the LSC Accounting Guide *Fundamental Criteria,* among others. LSA will conduct a review of our vendors to ascertain the status of contracts and/or to obtain written contracts for service.
Estimated Completion Date: No later than December 31, 2014
Office of Primary Responsibility: Director of Operations

Finding 7. Over review noted that grantee's fixed assets policy and procedures lacked certain components of the Property Acquisition and Management Manual (2001) (PAMM). In addition, the grantees current practice for physical inventory was inadequate. Specifically, physical inventory results were not reconciled with property records and issues were not followed up on that were identified during a physical inventory. Also, the subsidiary record and the master inventory records did not have all information required by the LSC Accounting Guide, such as the identification number, location of item and check number used to purchase the system.

Corrective Action Plan: LSA will develop written policies and procedures relating to the fixed assets to include physical inventories and property records in accordance with the LSC Accounting Guide, the LSC Property Acquisition and Management Manual, and LSC regulations, among others.
Estimated Completion Date: No later than December 31, 2014
Office of Primary Responsibility: Director of Operations

Finding 8. The grantee's current practices involving cost allocation, client trust funds, derivative income and internal *reporting and budgeting were generally in accordance with the LSC's* Fundamental Criteria. However, the documented cost allocation procedures need to provide sufficient details fully describing how costs are allocated. The written policies and procedures relating to client trust funds need to be revised to include all components of the *Fundamental Criteria*. Policies and procedures for derivative income and internal reporting and budgeting need to be documented in the grantee's Accounting Manual.

Corrective Action Plan: LSA will develop written policies and procedures relating to the cost allocation, client trust funds, derivative income and internal reporting and budgeting in accordance with the LSC Accounting Guide and LSC regulations, among others. LSA is rewriting the LSA Accounting Manual this year and will address the issues raised during the LSC OIG audit.
Estimated Completion Date: No later than December 31, 2014
Office of Primary Responsibility: Director of Operations

Finding 9. Finally, our tests confirmed that the amounts of salary advances requested by employees were adequately approved and did not exceed the net amount of two weeks pay as stipulated in the policies contained in the grantee's Accounting Manual. Our tests also confirmed from accounting records that the amounts deducted towards the repayment of the salary advances were accurate.
Corrective Action Plan: No action required. However, LSA deleted the provision for salary advances on February 5, 2013.