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March 24, 2014

Ms. Lois Wood
Executive Director
Land of Lincoln Legal Assistance Foundation
8787 State Street, Suite 201
East St. Louis, IL 62203

Dear Ms. Wood:

Enclosed is the Office of Inspector General's (OIG) final report of our audit on Selected Internal Controls at Land of Lincoln Legal Assistance Foundation. The OIG reviewed your comments to the draft report and has made the corrections noted. Your comments are included in the final report as Appendix II.

The OIG considers the proposed actions to address the report's four recommendations as responsive. However, all four recommendations will remain open until the OIG is notified in writing that the proposed action has been completed or implemented.

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

LAND OF LINCOLN LEGAL ASSISTANCE FOUNDATION

RNO 514050

Report No. AU14-01

March 2014

www.oig.lsc.gov

INTRODUCTION

The Legal Services Corporation (LSC) Office of Inspector General (OIG) assessed the adequacy of selected internal controls in place at Land of Lincoln Legal Assistance Foundation, Inc. ("LOLLAF" or "grantee") related to specific grantee operations and oversight. Audit work was conducted at the grantee's main office in East St. Louis, Illinois 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.

BACKGROUND

According to its website, Land of Lincoln Legal Assistance Foundation, Inc. (grantee) was incorporated in 1972, combining seven local legal aid organizations, six formerly under sponsorship of local bar associations and one sponsored by the Lawyers Committee for Civil Rights Under Law. LOLLAF is governed by its own Board of Directors made up of attorneys and eligible clients who live throughout their 65 county service territory. As of 2012, LOLLAF has five regional offices, three satellite offices, a centralized Legal Advice & Referral Center and 83 employees, including 47 full-time and part-time attorneys.

LOLLAF also indicates on its website that funding comes from LSC and other funding sources such as the Lawyers Trust Fund, Illinois Attorney General, Illinois Department of Human Services, US Department of Housing and Urban Development, local United Way organizations, the Illinois Criminal Justice Information Authority, the Department of Justice Violence Against Women Office, and Area Agencies on Aging. According to LSC's grant award letter, LOLLAF received a $2,331,529 basic field grant in 2012 and a $2,343,108 basic field grant in 2013. In addition, LOLLAF received $5.2 million in non-LSC funding in 2012.

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

In our opinion, the grantee needs to place more emphasis on establishing and documenting some internal controls. While most of the controls were adequately designed and properly implemented as they related to specific grantee operations and oversight, some controls need to be implemented, strengthened, or formalized in writing. Grantee disbursements tested generally were adequately supported and allowable. Controls over the selected regulations reviewed were designed in a manner expected to ensure compliance with the LSC Act and LSC regulations.

Controls over access to the grantee's accounting system need to be established. All four of the accounting staff and the Executive Director have unrestricted access within the accounting system. In addition, the system does not have the capability to create an audit trail to identify which employees input the various transactions within the system.

Controls over Client Trust Funds (CTF) need to be strengthened or established. CTF Receipt forms, which are the forms used to record funds received, were missing certain elements required by LSC's Accounting Guide. Also, CTF processing duties in the field offices are not segregated.

The grantee had adequate policies and procedures over salary advances. Our test of salary advances revealed that they were processed in accordance with the grantee's policy.

LOLLAF does not track non-capitalized information technology (IT) equipment; the grantee relies on an IT contractor to track that equipment for them. However, the contractor stated it is not its responsibility to track IT equipment for the program. The grantee also does not conduct biannual physical inventories of capitalized property as required by LSC's *Fundamental Criteria.*

LOLLAF needs to develop and implement policies and procedures related to budgeting and internal reporting, contracting, credit cards and derivative income. The practices in use for these areas were generally in accordance with LSC's Accounting Guide.

AUDIT FINDINGS

Accounting System Access

Controls over access to the grantee's accounting system need to be established. LOLLAF's accounting staff of four and the Executive Director all have unrestricted access to the modules and functions within the entire accounting system. The accounting staff consists of the Deputy Director of Finance and Administration (DDOFA), two Program Accountants, and the Accounting Assistant. Each of these employees has the ability to post, edit and delete transactions anywhere within the system.

Moreover, the Accounting System does not have the capability to produce an audit trail to show who posted transactions, including the initial entry of, changes to, or deletions of accounting transactions. As such, there is no audit trail or audit history available for review. The grantee has not implemented compensating controls to reduce the risk associated with the inability to restrict access to or track who made changes within the accounting system.

According to discussions with the DDOFA, the accounting system does not have the capability to restrict access and the capability to provide an audit trail due to the age of LOLLAF's accounting system. Consequently, there could be unauthorized transactions entered into the system or unauthorized changes to or deletions of transactions already in the system without management's approval or knowledge. The LSC Accounting Guide, Section 2-5, states the following: "A recipient's accounting records should be maintained on an automated system. Each recipient should establish the system most appropriate to its needs and provide an adequate audit trail for all transactions."

Restricting access to the accounting system and having the ability to produce an audit trail of who made entries to the accounting system reduces the potential for fraud or errors occurring or going undetected.

> Recommendation 1. The Executive Director should either update the accounting system or implement compensating controls to help reduce the risk of fraud or error. Examples of compensating controls include manually preparing and reviewing transaction logs or periodic reviews of significant transactions or accounts by an individual who does not have access to the accounting system.

Client Trust Funds

Controls over Client Trust Funds (CTF) need to be strengthened or established. During the period under review, CTF bank reconciliations were not being prepared correctly. This contributed to an alleged theft of funds not being discovered for approximately 2 years. A grantee staff member reported to the OIG Hotline on June 19, 2013, that an "alleged theft"[1] of $617.44, which occurred approximately 2 years ago, was discovered by the new Program Accountant.

According to the DDOFA, the new Program Accountant was instructed to re-perform all the Client Trust Fund reconciliations, for the past 2 years to the current date. As a result of performing those reconciliations, the Accountant was able to discover the missing funds. LOLLAF subsequently made a payment of $617.44 to the client trust account from its unrestricted funds account.

In addition to not properly preparing the reconciliations, our review of the CTF disclosed three other control weaknesses that need to be addressed by the grantee:

1. The CTF Receipt form did not have all the elements required by the LSC Accounting Guide. Missing from the form was the case number, method of payment and the purpose for which the funds were received. According to the DDOFA, he was unaware that there was a requirement for the CTF Receipt form to contain all the information stated in the LSC Accounting Guide.

2. Duties for receiving and disbursing CTFs were not properly separated. The secretary in each grantee office received funds from the clients after the amount was determined by the case attorney. The secretary prepared the receipt and the deposit slip and deposited the funds in the bank. The secretary also prepared the checks to disburse CTF funds; updated the client's ledger and the cash journal; prepared the outstanding checks report; and, prepared the reconciliations for the Managing Attorney to review and approve. The DDOFA stated that the program does not have enough employees to divide CTF responsibilities, especially in the regional offices. The DDOFA added that there are as few as two to four transactions per month in some of the regional offices. This is the reason the secretaries performed most of the CTF functions.

3. Client trust fund escheatment requirements were not documented. According to State of Illinois law, the grantee is required to escheat unclaimed property to the state after 5 years. According to the DDOFA they have never had any funds that needed to be escheated.

Establishing the proper internal controls ensures assets are protected and that fraud or errors are prevented or timely detected. Compensating controls, though not as strong as the ideal internal controls, provide at least some level of assurance that the fraud or error risk is reduced.

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[1] A grantee employee reported through the OIG hotline, that there was misappropriation of funds from the client trust account. The theft occurred 2 years earlier, but was discovered and confirmed on Wednesday, June 19, 2013. A client allegedly gave cash to her attorney, but the funds were never deposited to the bank. A receipt was issued and an entry made in the individual client ledger for $617.44. The attorney claimed that she gave the cash to the Administrative Secretary, who had no recollection of the event. The alleged theft happened at the Central Region Office in East St. Louis.

Recommendation 2. The Executive Director should ensure adequate controls over CFTs are documented, in place, and operating as designed. If necessary, compensating controls should be established to provide some reasonable assurance that fraud or errors will be prevented or detected in a timely manner.

Policies and Procedures

In addition to the areas listed above, policies and procedures for four areas reviewed were not in writing. Policies and procedures for two other areas needed strengthening.

1. Documenting Policies and Procedures. The grantee did not document its policies and procedures in use for four areas. These areas were Budgeting and Reporting, Contracting, Credit Cards, and Derivative Income. While our review disclosed that the practices employed by the grantee were adequate for each of the areas, those practices were not in writing.

2. Strengthening Policies and Procedures. Although the grantee does have written policies and procedures in the areas of property, the policies and procedures needed to be strengthened. The grantee's policies and procedures covering property did not address the following:

a. Procedures and documentation requirements for disposing of obsolete property.
b. The process and frequency of conducting physical inventories. The grantee does not conduct the required biannual physical inventory of property.
c. Procedures for controlling and tracking non-capitalized IT equipment that may contain sensitive or privileged information.

To maintain an adequate internal control structure to safeguard program resources, 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. Documented policies and procedures are an important part of internal control because the policies and procedures describe the control design, communicate management's expectations to the entire staff, help ensure consistent performance of activities over time, and provide much needed information so that staff members understand their roles and responsibilities.

Recommendations. The Executive Director should ensure that:

Recommendation 3. LOLLAF's Accounting Manual contains written policies and procedures addressing Budgeting and Internal Reporting, Contracting, Credit Cards, and Derivative Income.

Recommendation 4. Written policies and procedures for property address all required areas contained in LSC's Accounting Guide.

SUMMARY OF GRANTEE MANAGEMENT COMMENTS

Grantee management agreed in principle with all the findings and recommendations contained in the report. They have already begun to examine new accounting software and anticipate going live with the new software at the beginning of their next fiscal year on January 1, 2015. The prior Deputy Director of Finance & Administration had revised and implemented some CFT controls and policies. The current Deputy Director of Finance and Administration is reviewing those policies to ensure they are adequate. The grantee is also considering moving local CFT accounting to a restricted portion of their accounting system or to an independent Quick Books system.

The Executive Director has instructed the Deputy Director of Finance and Administration to have written policies and procedures on budgeting and internal reporting, contracting, credit cards and derivative income presented to the Board of Directors and approved before the end of 2014. Lastly, the Executive Director has instructed the Deputy Director of Finance and Administration to review the current written policies and procedures on property to ensure they address all required areas contained in LSC's Accounting Guide. Upon review and revision of these policies and procedures, grantee management will conduct an inventory as set forth in those policies. A copy of management's response is included as an appendix to this report.

OIG EVALUATION OF GRANTEE MANAGEMENT COMMENTS

The OIG considers management comments responsive to the findings and recommendations contained in the report. The grantee's planned actions to obtain an accounting system, implement new CTF policies and procedures, document policies and procedures on budgeting and internal reporting, contracting, credit cards and derivative income and to review their current written property procedures should correct the issues identified in the report.

The OIG considers all four recommendations open. Until the new accounting system has been implemented and the CTF policies have been reviewed and deemed adequate by the new Deputy Director of Finance and Administration, Recommendations 1 and 2 will remain open. Also, until all the above identified policies and procedures are written and approved by the grantee's Board of Directors, Recommendation 3 is also considered open. Lastly, until the Deputy Director of Finance and Administration has reviewed and revised the grantee current policies on property, we will consider Recommendation 4 open.

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
- Contracting
- Cost Allocation
- Credit Cards
- Salary Advances
- Property and Equipment
- Internal Management Reporting and Budgeting
- Client Trust Fund
- Derivative Income

To obtain an understanding of the internal controls over these areas, policies and procedures were reviewed, including manuals, guidelines, memoranda, and directives setting forth current practices. Grantee officials were interviewed to obtain an understanding of the internal control framework, and management 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 Accounting Guide.

We assessed the reliability of computer generated data provided by the grantee by reviewing source documentation for entries selected for review. We determined that the data were sufficiently reliable for the purpose of this report.

To test controls and the appropriateness of expenditures, disbursements from a judgmentally selected sample of employee and vendor files were reviewed. The sample represented 17.9 percent of the approximately $1.2 million disbursed for expenses other than payroll during the period January 1, 2012 to June 30, 2013 and consisted of 92 transactions totaling $215,005.20.

To assess the appropriateness of grantee expenditures, we reviewed supporting documentation such as invoices and vendor lists, and traced expenditures to the general ledger. The appropriateness of grantee 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 contracting, credit card use, derivative income, internal management reporting and budgeting, and property inventory, we interviewed appropriate program personnel, examined related policies and procedures, and selected specific transactions to review for adequacy. To gain an understanding 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 *Fundamental Criteria.* To review internal controls over compliance with select provisions of specific LSC regulations (45 CFR Parts 1612 and 1617), we examined written compliance policies and procedures, including applicable LSC mandated recordkeeping requirements, reviewed applicable documentation and reports, and interviewed staff to determine if the controls were designed in a manner to ensure compliance with the provisions of LSC regulations reviewed.

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

The on-site fieldwork was conducted at the grantee's main office in East St. Louis, IL from July 8, 2013 to July 17, 2013. Documents reviewed pertained to the period January 1, 2012 to June 30, 2013. The remainder of our work was conducted at LSC headquarters in Washington, DC.

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

LAND OF LINCOLN
LEGAL ASSISTANCE FOUNDATION, INCORPORATED

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March 13, 2014

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

RE: Draft Report on Selected Internal Controls: Report No. AU14-XX

Dear Mr. Merryman:

Thank you for the opportunity to provide comments on the Draft Report of the audit your staff conducted last summer. As you already know, the long term employee serving as Deputy Director of Finance & Administration at the time of the audit retired on December 31, 2013. His successor, who was present for the audit process, found the audit exit conference quite useful in planning which issues would be addressed first during 2014. Before commenting on the specific recommendations made in the draft report, we would like to clarify a couple of things mentioned in the text of the report.

In the last sentence on page 1 you write, "In addition, LOLLAF received $8.4 million in non-LSC funding in 2012." Actually, our total revenue, including donated services, was $8.4 million in 2012. Of that total, $5.2 million was non-LSC funding, of which just under $1.0 million were donated services.

In the third sentence of the footnote on page 4 regarding the missing funds form our client trust account you write, "A client allegedly gave cash to the program's receptionist..." The client actually gave the cash to her attorney. Two sentences later you write, "The receptionist claimed that she gave the funds to the petty cash officer; however the petty cash officer has no recollection…" The sentence should state that the attorney claimed that she gave the cash to the Administrative Secretary, who had no recollection of the event. Finally, in the last sentence you write, "The alleged theft happened at the Joliet office location." The incident actually happened at the Central Region Office in East St. Louis. Joliet is not in our service territory.

Land of Lincoln concurs with Recommendation 1. The accounting staff had already begun to examine new accounting system software prior to the receipt of this draft report. Our current timeline includes choosing a new system by mid 2014, installing the system and training the accounting staff during the second half of 2014, and barring any complications, going live at the start of our next fiscal year on January 1, 2015.

Land of Lincoln concurs with Recommendation 2. The prior Deputy Director of Finance & Administration had revised and implemented some CFT controls and policies prior to receipt of this draft report. At the request of the Executive Director, our current Deputy Director of Finance & Administration is reviewing these policies and controls to make certain that they will be adequate. One thing being considered is moving local CFT accounting to a restricted portion of our new accounting system or to create an independent Quick Books system instead of using the current self-generated Excel forms.

Land of Lincoln concurs with Recommendation 3. The Executive Director has instructed the Deputy Director of Finance & Administration to have written policies on Budgeting & Internal Reporting, Contracting, Credit Cards and Derivative Income reviewed by the OIG, presented to its Board of Directors and approved before the end of 2014.

Land of Lincoln concurs with Recommendation 4. The Executive Director has instructed the Deputy Director of Finance & Administration to review our current written policies and procedures for property to ensure that they address all required areas contained in the LSC's Accounting Guide. Upon review and revision of these policies and procedures, the Deputy Director will conduct an inventory as set forth in those policies.

We look forward to receiving your final report.

Sincerely,

Lois Wood

Lois Wood
Executive Director

Christopher A. Dain

Christopher A. Dain
Deputy Director of Finance & Administration