



Office of Inspector General
Legal Services Corporation

Inspector General
Jeffrey E. Schanz

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December 06, 2018

Mr. Darrell Moore
Executive Director
Inland Counties Legal Services, Inc.
1040 Iowa Avenue
Suite 109
Riverside, CA 92507

Dear Mr. Moore:

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

The OIG considers the proposed actions to address Recommendations 1 through 5, 7 through 10, 17, and 18 as fully responsive and considers the recommendations closed. The proposed actions for Recommendations 6 and 11 through 16 are considered partially responsive and require further action.

Recommendation 6 will remain open until the grantee addresses the recommendation regarding ensuring the fixed asset records and general ledger are adjusted for those assets that have been retired and provides supporting documentation for adjustments related to retired fixed assets. The actions planned by grantee management to address the issues to Recommendations 11, 12 and 13 will remain open until revisions to the Accounting Manual are provided.

Recommendation 14 will remain open until documentation is received supporting timely management reports. Recommendation 15 will remain open until documentation is received supporting timely bank reconciliations. Recommendation 16 will remain open until documentation is received for resolution of outstanding checks greater than six months.

Please provide us with your response to close out the seven open recommendations along with the revised Accounting Manual 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 May of 2019.

Sincerely,

A handwritten signature in black ink, appearing to read 'Jeff E. Schanz', followed by a horizontal line.

Jeffrey E. Schanz
Inspector General

Enclosure

cc: Legal Services Corporation
Jim Sandman, President

Lynn Jennings,
Vice President for Grants Management

Inland Counties Legal Services, Inc.
Elaine S. Rosen, President
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LEGAL SERVICES CORPORATION

OFFICE OF INSPECTOR GENERAL

**FINAL REPORT ON SELECTED INTERNAL
CONTROLS**

INLAND COUNTIES LEGAL SERVICES, INC.

RNO 805230

Report No. AU 19-01

December 2018

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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 Inland Counties Legal Services (ICLS or grantee) related to specific grantee operations and oversight. Audit work was conducted at the grantee's administrative office in Riverside, CA 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

Inland Counties Legal Services (ICLS) is a nonprofit organization providing legal services to low-income persons residing in Riverside and San Bernardino counties. ICLS targets services to seniors in social and economic need. Legal assistance is provided in areas including housing, family, consumer/civil, public benefits, elder abuse, citizenship clinics, bankruptcies, healthcare access, and domestic violence.

ICLS receives funding from various sources including LSC, the State Bar Trust Fund, the Department of Justice, and Special Programs for the Aging. Per the audited financial statements for December 31, 2016, LSC provided 72 percent or \$5,327,741 of the grantee's total funding amount of \$7,384,062. LSC is the grantee's major funding source.

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. The audit evaluated select 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.

AUDIT FINDINGS

To accomplish the audit objective, the OIG reviewed and tested internal controls related to disbursements, derivative income, fixed assets, cost allocation, contracting, internal reporting and budgeting, general ledger and financial controls, credit cards, employee benefits, payroll, and client trust funds. While the controls for employee benefits, payroll, and client trust funds were adequately designed and properly implemented as they relate to specific grantee operations and oversight, controls in the areas detailed below need to be strengthened and formalized in writing.

DISBURSEMENTS

The OIG judgmentally selected and reviewed 86 disbursement transactions totaling \$380,508. Selected transactions included large amounts, unfamiliar vendors, employee reimbursements, bank payments, dues, memberships, conferences, training, contract services, and office supplies. During interviews with ICLS staff and test work performed, some inadequate practices were found as follows.

LSC Unallowable Costs

In general, all the grantee's expenses are coded to LSC. During test work, two membership fees charged to LSC totaling \$11,000 were found. Normally, the membership fees are treated as a prepaid expense, initially charged to LSC and later re-allocated to other funding sources each month. At the time the field work was conducted, the \$11,000 had not been re-allocated from LSC funds.

The Controller explained that the membership fees currently charged to LSC will be re-allocated to Interest on Lawyers Trust Accounts (IOLTA) each month.

45 CFR §1630.7 stipulates that LSC funds may not be used to pay membership fees or dues to any private or nonprofit organization, whether on behalf of a grantee or an individual.

Ensuring a timely and consistent method for allocating LSC unallowable costs, maintaining adequate supporting documentation and appropriate approvals help ensure that grantees use funds only for authorized purposes. Failure to reallocate LSC unallowable expenses will result in noncompliance with 45 CFR § 1630.3.

Re-issued Checks

During an interview with the Controller, the OIG found that the grantee does not issue stop payment requests on lost checks. For the period reviewed, the grantee reissued 27 checks totaling \$53,108 without issuing stop payments on the initial checks.

The ICLS Accounting Manual stipulates that once a check has been identified as lost, a stop payment order will be made for that check in accordance with the following procedure. The Controller will verify the bank statement online to determine if the check had been cashed at the time the check was reported lost. Once the determination is made, the Controller will email the bank representative a stop payment request. Upon bank confirmation, via email, that the stop payment has been issued, a new check shall be written.

The Controller explained that stop payment requests are too costly as the bank charges \$30 per request. Not processing stop payments on lost checks increases the risk for duplicate payments, check theft, and forgery.

LSC Prior Approval

During OIG test work, it was noted that the grantee purchased a total of 60 computers exceeding \$10,000 for which the grantee did not obtain LSC prior approval, as required. The computer purchase was approved by the Board of Directors to replace computers in several offices that were more than three years old. The computers were purchased from the same vendor on two separate occasions. The disbursements took place in January and October 2017. The amounts paid with LSC funds were \$12,413 and \$19,186, respectively.

The Controller provided documentation of the Board of Directors' approval for the purchase of the computers; however, she was unable to provide documentation of prior approval from LSC.

The ICLS Accounting Manual and the LSC regulation in effect at the time of the purchase (45 CFR §1630.5) stipulate that no costs can be charged against LSC funds if prior written approval is not obtained for purchases and leases of equipment, furniture, or other personal, non-expendable property, if the current purchase price of any individual property item exceeds \$10,000. The Regulation has since been updated and the revised regulation became effective December 31, 2017. As now required by 45 CFR §1630.6(b) and 1631.3, a grantee must request and receive prior approval from LSC for any purchase before the expenditure of LSC funds amounting to \$25,000 or more for the purchase or lease of personal property or service contracts.

Failure to obtain required LSC prior approval may subject the expenditure to a questioned cost proceeding.

Segregation of Duties

During interviews with ICLS staff, the LSC OIG determined that the grantee lacked segregation of duties over maintenance of the master vendor list. The accounting staff,

comprised of the Controller, Full-Charge Bookkeeper, and Bookkeeper, had full access to the master vendor list. In addition, the Full-Charge Bookkeeper in charge of accounts payables, which includes initiating and processing payments, was also responsible for making changes to and adding new vendor information.

The Controller explained she is currently reviewing each of the accounting staff member's responsibilities. She added that the responsibilities of the accounting staff need to be changed, however it has been an ongoing process due to the high turn-over in their department.

The LSC Accounting Guide, Section 3-4.3, stipulates that accounting duties should be segregated to ensure that no individual simultaneously has both physical control and record keeping 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.

Without adequate segregation of duties between the accounts payable function and the master vendor list, an individual staff member could initiate, execute, and record a transaction with an unauthorized vendor.

Recommendations: The Interim Executive Director should:

Recommendation 1: ensure LSC unallowable costs are not charged to LSC funds.

Recommendation 2: enforce the stop payment policies of the Accounting Manual over lost checks or determine a cost-efficient alternative to prevent duplicate payments of disbursements.

Recommendation 3: revise the policies in the ICLS Accounting Manual to reflect new requirements included in 45 CFR §1630.6, effective December 31, 2017, to obtain prior approval from LSC for covered purchases of \$25,000 or more.

Recommendation 4: ensure the duties of the person maintaining the master vendor file and the person making payments are segregated or consider having another authorized person review the master vendor list and all related edits and changes to the list on a periodic basis.

DERIVATIVE INCOME

ICLS's written policies and procedures regarding the allocation of derivative income, including attorneys' fees, were adequate and consistent with 45 CFR Part 1630. However, the grantee did not always adhere to these written policies and procedures. The OIG tested all 55 transactions of interest income totaling \$7,492 as well as all three transactions of attorneys' fees totaling \$118,510 within the audit period.

For the three attorneys' fees tested, one was allocated according to the written methodology, the remaining two were not. One case totaling \$3,000 was allocated 100 percent to the Foreclosure Prevention Assistance Program (FPAP), whereas

supporting documentation noted approximately 15 percent or \$450 should have been allocated to LSC. The other case totaling \$13,607 was allocated 100 percent to the Equal Access Fund, however supporting documentation noted approximately 37 percent or \$5,035 should have been allocated to LSC and 19 percent or \$2,585 to FPAP.

The Bookkeeper stated she was unsure why the attorneys charged their time to multiple funders when the case was allocated to a specific funder.

45 CFR §1630.17 states that derivative income resulting from an activity supported in whole or in part with funds provided by LSC shall be allocated to the fund in which the grantee's LSC grant is recorded in the same proportion that the amount of the LSC funds expended bears to the total amount expended by the grantee to support the activity.

Properly allocating derivative income results in a fair allocation of derivative income back to appropriate funding sources.

Recommendation 5: The Interim Executive Director should ensure that staff follow the methodology to allocate derivative income and attorneys' fees as written in the grantee's Accounting Manual.

FIXED ASSETS

The OIG non-statistically selected 22 items from both the IT department's mobile device records, which includes laptops and iPads, as well as the 2016 property records. While on site, testing could not be performed of the most recent property records because the grantee was in the process of updating the records from the physical inventory that was conducted in December 2017.

During testing, the OIG was unable to verify the existence of six items: five iPads and one laptop. The staff assigned these items did not have them on-site at the time of test work, however, the IT Technician and the staff verbally confirmed their existence. One disposed item, per the IT Technician, was not recorded as a disposal in the inventory records. While we were not presented the items on-site, management provided pictures of the items at a later time. For one of the six items, on the picture provided, the tag number did not agree with the tag number included in the property records provided on site.

According to the Bookkeeper, some mobile devices and sensitive equipment were not included in the inventory records because they are below the capitalization threshold. She also stated they overlooked the disposed item and will update the 2017 inventory records.

The Accounting Guide, Section 2-2.4, stipulates that grantees should be mindful of items that may contain sensitive information with values less than the capitalization threshold and the need to inventory these items and dispose of them appropriately. For property control purposes, a physical inventory should be taken and the results reconciled with the property records at least once every two (2) years. The accounting records should be reconciled to the results of the physical inventory. Inadequate property records may result in difficulty tracking items resulting in the inability to fully account for fixed asset purchases as well as support depreciation amounts and property asset balances. Without an adequate and complete tracking system for all electronic items, there is no assurance

that the grantee is properly safeguarding equipment and the information contained therein.

Recommendation 6: The Interim Executive Director should ensure all sensitive equipment is appropriately tracked and fixed asset records and the general ledger are adjusted for those assets that have been retired.

COST ALLOCATION

In practice, the grantee does not perform cost allocations in accordance with the LSC Accounting Guide. The grantee allocates all administrative salaries to LSC, even though these positions support work funded by more than one grant and allocates direct salaries per pay period. The ICLS administrative staff consisted of 12 full time employees during the scope of our audit. The OIG non-statistically selected five administrative staff timesheets for four of the twelve months included in our scope, to determine if the time was allocated appropriately and in accordance with the grantee's policies and procedures. Four of the five administrative staff's time was allocated 100 percent to LSC.

The Controller explained administrative salaries were allocated to LSC prior to her joining the grantee and she has yet to change it. She also explained she made the change to allocate direct salaries per pay period instead of quarterly as it was easier to do so.

The ICLS Accounting Manual states that indirect expenses are allocated among all funds, based on the actual grant amount and that direct time allocation is done every quarter. The LSC Accounting Guide Section 3-5.9 stipulates that common expenses shall be allocated to funding sources on the basis agreed to by the applicable funding organizations, and in the absence of approved methods the allocation should be fair, consistent, and in an equitable manner to the individual cost centers, and funds. Further, the allocation formula should be adequately documented in writing with sufficient detail for the auditor, LSC, OIG, GAO and others, to easily understand, follow, and test the formula.

Without a consistent systematic basis for allocating costs, there is no assurance that LSC and other funding sources will receive their fair and equitable share of the costs.

Recommendation 7: The Interim Executive Director should ensure the practices used to allocate costs to funding sources are consistently applied and follow ICLS's documented written policies by: (1) allocating administrative salaries and other salaries of positions that support work funded by more than one grant among all funds, and (2) performing direct cost allocation of salaries quarterly as the grantee's Accounting Manual states or updating the manual to match practices.

CONTRACTING

The OIG judgmentally selected and reviewed 16 contracts totaling \$317,398. Most of the deliverables were confirmed by the grantee and there were practices in place over vendor procurement. However, the practices were not consistently applied, and the processes used for each contract action were not fully documented in the file as follows:

- One sole-source contract had no documentation of justification on file. Justification of a sole-sourced contract is required when only one known source exists or only one single supplier fulfills the requirement. One vendor's invoice did not match the agreed upon rate or terms as per the written contract.
- Two contracts did not include the rate, description of work and timeframe for completion of the work.
- Four vendors had missing contracts, therefore, it could not be determined if deliverables were identified, monitored and invoiced per the contract terms agreed upon.
- Seven contracts had no documentation of required approvals.
- Thirteen contracts had no documentation of bids.

The Human Resources Manager, responsible for contract services, explained that the majority of the contracts were entered into prior to her tenure and that to her knowledge all contracting documentation was provided to the Accounting Department. However, she stated the Accounting Department has had so much staff turnover that it's possible this is the reason documentation was not found.

The LSC Accounting Guide, Section 3-5.16, stipulates that all documentation supporting competition and the process used for each contract action be maintained in a central file. Any deviation from the approved contracting process should be fully documented, approved and maintained in a contract file. In addition, the statement of work should be sufficiently detailed so that contract deliverables can be identified and monitored to ensure they are complete. Documents to support competition should be retained and kept with contract files.

Without a formal contract, the statement of work and other contract terms cannot be adequately communicated, monitored and enforced, which may hinder management's ability to prevent or detect the risk of fraud, waste or abuse. Failure to maintain proper documentation lessens assurance that the approved contract has followed all established procedures.

Recommendations: The Interim Executive Director should ensure that:

Recommendation 8: contract agreements are written, signed and maintained for business arrangements, especially those recurring in nature. The contracts should fully document the agreed upon terms, price, and payment terms. Contracts should be reviewed periodically to ensure that written terms are defined and current.

Recommendation 9: the process for each contract action is fully documented in writing, such as sole source justification and documentation of competition, if competitively bid.

Recommendation 10: the centralized filing system for all contracts is maintained and contains all pertinent documents related to the solicitation of bids, including receipt and evaluation of bids, sole source justification, vendor selection, a signed contract or agreement, required approvals, and any agreed upon modifications to a contract or agreement.

WRITTEN POLICIES

The OIG reviewed ICLS's Accounting Manual for policies covering disbursements, contracting, fixed assets, credit cards, cost allocation, derivative income, internal reporting and budgeting, general ledger and financial controls, employee benefits, payroll, and client trust funds. While provisions governing derivative income, employee benefits, payroll, and client trust funds included adequate procedures, other areas need to be enhanced, including:

AREA	CONDITION	EFFECT	CRITERIA
Cost Allocation	The cost allocation policy did not describe the allocation methodology for LSC unallowable expenses.	Without detailed procedures for allocating LSC funds for unallowable expenses, there is an increased risk that LSC grant monies may be used to fund unallowable expenses.	Per 45 CFR §1630.5(a)(2), expenditures are allowable under a LSC grant or contract only if the grantee can demonstrate that the cost was reasonable and necessary for the performance of the grant or contract as approved by LSC.
Internal Reporting and Budgeting	There were no written policies in place regarding the budgeting process.	Without detailed written policies, ICLS management does not have documentation that establishes procedures to facilitate the review, discussion, and adoption of a proposed budget to adequately control and plan the program's expenditures.	Per Section 3-5.10 of LSC's <i>Fundamental Criteria</i> , the budgeting process should be organized, involve top management, and be closely tied to the goals and priority setting process of the grantee. The budget should be built from cost center/function and "rolled-up" to create the total budget. Schedules should document the assumptions made in arriving at the final cost center/functional budgets.
Disbursements	The disbursement policy did not include procedures over the maintenance of the master vendor list.	Without adequate segregation of duties between the accounts payable function and the master vendor list, the Controller may not be able to detect unauthorized changes to vendor information which may further lead to fraud, waste or abuse of the grantee's resources.	Per Section 3-4.3 of LSC's <u>Accounting Guide</u> , 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.
Fixed Assets	The fixed assets policy did not include policies and procedures for tracking electronics with sensitive information that are not capitalized.	Without detailed written policies regarding a tracking system for all electronic items, there is limited assurance that the grantee's management has provided guidance to staff to properly safeguard equipment and the information contained therein.	Per Section 2-2.4 of LSC's <u>Accounting Guide</u> , the grantee should be mindful of items that contain sensitive information with values lower than \$5,000 and the need to inventory these items and dispose of them appropriately.

Contracting	The contracting policy did not include detailed procedures for various types of contracts, dollar thresholds, and competition requirements.	Contracting is a high-risk area for potential abuse. Without an adequate written contracting policy for all types of contracts, contracts may lack proper documentation and approval.	Per Section 3-5.16 of LSC's <i>Fundamental Criteria</i> , 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.
General Ledger and Financial Controls	The general ledger and financial controls policy lacked information on how the accounting system provides for separation of receipts and disbursements of LSC and non-LSC funds in accordance with 45 CFR § 1610.9 (now 45 CFR § 1610.8).	The failure to fully incorporate fund accounting into the program's accounting system may result in an inability to document compliance with federal requirements. The reliability of management reports generated from sources other than the general ledger may be significantly impaired and the actual report preparation significantly more cumbersome.	Per Section 3-5.8(b) of LSC's <i>Fundamental Criteria</i> , the general ledger design should accommodate fund accounting, and/or cost center accounting/functional accounting and other financial requirements in accordance with the most expedient procedures in the circumstances.
Credit Cards	The credit card policy lacked details regarding prohibiting cash advances, ATM withdrawals, and personal use.	A strong, clear, well-communicated policy is necessary to properly manage credit cards, and proper management is a key defense against abuse. The lack of a policy could result in use, management and oversight of credit cards that is inconsistent and unclear. These conditions make it more likely that credit-cards will be misused, whether accidentally or intentionally.	Refer to Appendix VII Section G3 of the LSC <u>Accounting Guide</u> that identifies proper internal controls over credit cards including personal use being prohibited even for authorized users and disallowing cash advances or ATM withdrawals.

The Controller stated she is aware that the Accounting Manual needs to be updated but was unaware that this level of detail was required. Accounting Manual updates have been an on-going process due to high turn-over in the Accounting Department and an internal review of current accounting staff's responsibilities. The Controller explained practices are in place over unallowable expenses; however, the manual needs to be updated to reflect these processes.

The LSC Accounting Guide, Section 3-4, states 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 of an Accounting and Financial Reporting System (Fundamental Criteria)* contained in the LSC Accounting Guide.

Recommendation 11: The Interim Executive Director should ensure written policies and procedures are included within the grantee's Accounting Manual and that they adequately describe the processes and controls in sufficient detail, are in accordance with LSC's Accounting Guide and *Fundamental Criteria*, and reflect the current staff assigned to specific duties.

INTERNAL REPORTING AND BUDGETING

No Budgeting Process

During interviews with the Interim Executive Director and Controller, LSC OIG determined that the grantee had not developed or implemented a budgeting process. The Controller explained that the grantee budgets per grant received are based on prior years, known personnel changes, and known expenditure changes, but the grantee has not developed an overall budget.

The Interim Executive Director stated he is aware that the grantee needs to develop an overall budget, but he has not yet been able to do so.

The LSC *Fundamental Criteria*, Section 3-5.10, states that the budgeting process should be organized, involve top management, and be closely tied to the goals and priority setting process of the recipient. The budget should be built from cost center/function and "rolled-up" to create the total budget. Schedules should document the assumptions made in arriving at the final cost center/functional budgets.

Budgeting and projecting are tools used by management to adequately control and plan the program's expenditures. A lack of budgeting projections can weaken information provided to management to compare actual cash flow and expenses and determine whether their financial positions will be as expected during the year.

Discrepancy Between Written Policies and Internal Practices

ICLS's written policies and procedures for management reporting were comparable to LSC's *Fundamental Criteria*. However, there was a discrepancy between the written policy and actual practice. An interview with the Controller determined that two financial management reports were no longer being prepared while ICLS's Accounting Manual states they will be prepared quarterly.

The Controller stated that she did not find the quarterly reports useful and preferred the details and information provided in monthly reports, so she stopped preparing those quarterly reports.

The LSC Accounting Guide, Section 3-4, states that 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*.

Written policies and procedures serve as a method to document the design of controls and communicate them to staff. Not following current detailed written procedures could lead to management not having the financial information needed to plan for future needs of the organization.

Management Reports Not Prepared Timely

The LSC OIG found that not all management reports were being prepared timely. Management reports prior to September 2017 were not prepared until October 2017. Also, one monthly report required per the Interim Financial Reporting Log was not prepared during 2017.

The Controller stated that she had to catch up on preparing reports that were not prepared by the previous Controller. She also stated she had not had time to prepare the budget versus actual narrative management report.

The LSC *Fundamental Criteria*, Section 3-5.9, states that the director should receive a monthly management report within a prescribed number of days after month-end and that the director should use the monthly management reports to ensure that all program resources are used efficiently and effectively.

Untimely management reports may result in the director not receiving required monthly reports within a prescribed number of days after month-end to ensure program resources are used efficiently and effectively.

Recommendations: The Interim Executive Director should ensure that:

Recommendation 12: an annual budget is developed, documenting the assumptions, getting top management involved, and obtaining approval from the grantee's Board of Directors.

Recommendation 13: the grantee's Accounting Manual is updated to reflect the reports prepared, and that all management reports required by the LSC *Fundamental Criteria* are prepared including Total Program Budget vs Actual, Funding Source Budget vs. Actual, and Statement of Cash on Hand.

Recommendation 14: all management reports are prepared timely after month-end.

GENERAL LEDGER AND FINANCIAL CONTROLS

Bank Reconciliations Not Prepared Timely

During the OIG audit scope, ICLS had eight bank accounts open and active. The OIG non-statistically selected specific months of bank reconciliations from each bank account for testing, resulting in the selection of 15 of 84 bank reconciliations performed during the audit scope. Of the 15 bank reconciliations reviewed, seven reconciliations from four different bank accounts were not prepared timely. Two of the untimely bank reconciliations were prepared while the OIG was onsite.

Per the Controller, the untimely performance of bank reconciliations was due to previous management. However, she stated that she is working towards performing the bank reconciliations on a timely basis. The LSC *Fundamental Criteria*, Section 3-5.2(d), states that bank statements shall be reconciled monthly to the general ledger by a person who has no access to cash, who is not a regular check signer, and has no cash bookkeeping duties.

When bank statements are not monitored and reconciled monthly, the potential for undetected loss is high. Reconciling your bank statement monthly substantially increases the likelihood of discovering irregular disbursements and recording errors on a timely basis.

Outstanding Checks

During the review of the 15 bank reconciliations, four bank reconciliations had a total of 12 outstanding checks over six months old.

Although the Controller stated there is no process in place to handle outstanding checks, there is a procedure documented in the grantee's Accounting Manual. The Controller further stated that she tried to contact the recipients of the outstanding checks to have them deposited but has not been able to completely clear all the outstanding checks. She stated that the grantee does not have an escheat process in place and she would have to do some research on the process.

The ICLS Accounting Manual stipulates the Controller is responsible for voiding checks that have been outstanding for more than six months from the date of their issue. The outstanding checks had been unresolved for more than six months because the grantee was not following its own written procedures. Not monitoring and resolving outstanding checks timely may result in undetected fraudulent signatures or endorsements, alterations of checks, improper use of voided checks, and improper recording of bank transfers.

Recommendations: The Interim Executive Director should ensure that:

Recommendation 15: bank reconciliations are performed monthly, documented with a signature and date, and reviewed and approved by a responsible individual.

Recommendation 16: grantee personnel adhere to the policy of investigating outstanding checks and management follows up to void or reissue any checks outstanding for more than six months as required by the grantee's policy.

CREDIT CARDS

The OIG judgmentally selected and reviewed 22 credit card transactions from eight different credit card statements totaling \$13,752. Credit card statements containing transactions possibly unallowable with LSC funds including travel expenses, and other potentially questionable or significant charges were reviewed. Interviews with ICLS staff and test work found some inadequate practices relating to the lack of approvals and documentation as follows.

Discrepancies Between Written Policies and Internal Practices

During test work, the OIG found that requisite approval was not obtained for four of the 22 transactions totaling \$225. The ICLS Accounting Manual states that authorizations to use any of the program's credit cards is obtained through the written approval of the Executive Director or the Executive Director's designee. The Bookkeeper stated that missing requisite approvals might have resulted from a management oversight.

The OIG also found that adequate supporting documentation was not attached for four of the 22 transactions totaling \$229. The transactions involved a missing list of participants for a luncheon and missing vendor information for recurring charges and automatic payments. According to the Bookkeeper the lack of adequate support was due to a lack of oversight as well as missing supporting vendor contracts.

The ICLS Accounting Manual stipulates that supporting documentation be attached, e.g., applicable invoices, travel reports, bills, or signed itemized expense reports, as well as any authorization requests made by the Executive Director, to pay obligations.

The approval process prevents purchases from being made without the knowledge of appropriate management or at unacceptable prices or terms. Adequate supporting documentation provides justification that credit card purchases are allowable and support the organization's purpose.

Recommendations: The Interim Executive Director should:

Recommendation 17: ensure that the requisite approval is obtained on all transactions prior to payment of the credit card statement.

Recommendation 18: ensure that adequate supporting documentation is attached for all transactions.

SUMMARY OF GRANTEE MANAGEMENT COMMENTS

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

- ICLS reallocated the membership fees and has a system in place to ensure proper allocation of expenses to the appropriate funds.
- The grantee has changed banks to an institution that does not charges fees and will follow the stop payment rule as outlined in the Accounting Manual.
- The disbursements in question were for the purchase of items that individually were under \$10,000, however, ICLS has updated its policies and procedures to follow current LSC regulations.
- ICLS hired a new bookkeeper to process accounts payable and cash disbursements.
- The grantee agreed there was an error in allocating derivative income and corrected the amount during the year-end closing.
- ICLS has procedures in place to track sensitive equipment and will consider making improvements to controls and processes while updating the Accounting Manual.
- The Board of Directors adopted a revised cost allocation policy. Corrections to cost allocations were made in the accounting system during the year.
- ICLS revised the contract policy and is currently reviewing all vendors, updating files and requisite purchasing documentation, and moving the files to a centralized location.
- ICLS created a position that will oversee the documentation and revision of program policies and manuals in consultation with other management personnel.
- An overall program budget for the 2018 year was prepared and approved.
- The Accounting Manual will include internal controls over the budgeting process and remove reports that are not useful to management.
- Approval from the Executive Director was obtained for management reports that were not prepared as they were not considered useful and was reported to the Board of Directors with no objections raised.
- A new staff member was added to accommodate the increased work load of management reports and bank reconciliations.
- Accounting staff is resolving old checks. Policies and procedures will be revised based on escheat law research.
- The Executive Director will ensure requisite supporting documentation and that proper approval is attached to the credit card statement when signing checks.
- ICLS will revisit the internal controls and procedures over credit card transactions during its revision of the Accounting Manual.

OIG EVALUATION OF GRANTEE MANAGEMENT COMMENTS

The OIG considers the proposed actions to address Recommendations 1 through 5, 7 through 10, 17, and 18 as fully responsive. The proposed actions for Recommendations 6 and 11 through 16 are considered partially responsive and require further action.

Recommendation 6 will remain open until the grantee addresses the recommendation regarding ensuring the fixed asset records and general ledger are adjusted for those assets that have been retired and provides supporting documentation for adjustments related to retired fixed assets.

Recommendations 11, 12 and 13 will remain open until the OIG receives the updated Accounting Manual.

Recommendation 14 will remain open until the OIG receives supporting documentation of timely management reports.

Recommendation 15 will remain open until the OIG receives supporting documentation that bank reconciliations are up to date.

Recommendation 16 will remain open until the OIG receives supporting documentation resolving outstanding checks greater than six months.

Recommendations 1, 2, 3, 4, 5, 7, 8, 9, 10, 17, and 18 are considered closed.

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,
- Client Trust Funds,
- Employee Benefits, and
- Payroll.

To obtain an understanding of the internal controls, grantee policies and procedures were reviewed, including manuals and guidelines setting forth current grantee practices. Grantee officials were interviewed to obtain an understanding of the internal control framework; management and staff were interviewed as to their knowledge and understanding of the processes in place. To 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 not sufficient for expressing an opinion on the entire system of grantee internal controls over financial operations.

To assess the reliability of computer generated data the grantee provided, the OIG examined available supporting documentation for the entries selected for review, conducted interviews, and made physical observations to determine data consistency and reasonableness. The data was 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 vendor files were reviewed. The sample consisted of 86 disbursement transactions totaling \$380,508. The sample represented approximately 9 percent of the \$4,070,115 disbursed for expenses other than payroll during the period January 1, 2017 to January 8, 2018. To assess the appropriateness of expenditures, invoices and vendor lists were reviewed, then the expenditures were traced 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 disbursements, a sample of 22 credit card transactions totaling \$13,752 was judgmentally selected. The appropriateness of the expenditures was assessed, and the OIG checked for the existence of approvals and adequate supporting documentation.

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

To evaluate the adequacy of the cost allocation process, the cost allocation process was discussed with grantee management and the grantee's written cost allocation policies, procedures, and practices were reviewed. We tested selected transactions to determine if the amounts allocated were in conformity with the documented grantee allocation process and if the transactions were properly allocated in the accounting system.

The on-site fieldwork was conducted from January 8, 2018 through January 12, 2018. Audit work was conducted at the grantee's administrative office in Riverside, CA and at LSC headquarters in Washington, DC. Documents reviewed pertained to the period January 1, 2017 through January 8, 2018.

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.

APPENDIX II



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September 28, 2018

Mr. Anthony Ramirez
Director of Planning, Policy and Reporting
Legal Services Corporation Office of Inspector General
3333 K Street N.W.
Washington, D.C. 20007

Dear Mr. Ramirez,

Inland Counties Legal Services (ICLS) thanks the Office of Inspector General for its comments and guidance on how to improve ICLS's financial internal controls, and the opportunity given to us to respond to your comments. ICLS's responses are organized by recommendation numbers included in the report.

1. Disbursements – Disbursements (including those tested as described in Recommendation 1) are not charged to a grant in ICLS's accounting system until they are coded to expense. However, the majority of ICLS's balance sheet accounts were set up in the LSC fund rather than the general fund. The disbursements selected by the OIG team for review, as listed in Recommendation 1, were for memberships to NLADA and the California Project Directors Association. These disbursements were recorded in prepaid expense. Each month, these disbursements are expensed and charged to other grants that allow membership dues. This practice has been in place at ICLS for many years; in hindsight, ICLS understands that recording balance sheet accounts in its accounting system in the LSC fund may not be the most appropriate way to set up the accounting system. The \$10,000 payment for NLADA included \$9,000 for membership and \$1,000 for subscriptions. The payment was made in December 2017 for the entire 2018 year and was recorded in prepaid

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expense, and has now, in 2018, been properly allocated to other grants through August 2018. The \$6,002 payment to California Project Directors Association was fully amortized to expense to IOLTA and State Equal Access Funds in 2017. ICLS has provided supporting documentation to verify the reallocation of expense. If the recommendation is to put procedures in place to ensure proper allocation to the appropriate fund for expenses, ICLS believes that it has a system in place. Additionally, if the recommendation is that the disbursements should never have been recorded in a prepaid account that was part of ICLS's LSC fund, then ICLS does not disagree as to the merits of the recommendation to reconfigure the accounting system, but implementing such a sweeping change to the accounting system will be challenging due to limited resources therefore ICLS request clarification prior to making the change.

2. Disbursements – ICLS agrees with the recommendation and has changed banks to one that does not charge fees. In 2018, accounting staff follows the stop payment rules as outlined in the Accounting Manual.
3. Disbursements – The disbursements in question were in January and October 2017 and were for the purchase of items that individually were under \$10,000 and therefore not requiring prior approval according to ICLS's interpretation of 45 CFR §1630 in effect at that time. ICLS has revised its policies and procedures in 2018 to comply with changes to the regulation. The revised purchasing section of the Accounting Manual is attached.
4. Disbursements – ICLS agrees with the recommendation and has since hired a new bookkeeper to process accounts payable and cash disbursements. The new bookkeeper does not have access to add or edit the master vendor list in the accounting system.
5. Derivative income – ICLS concurs that there was an error in the calculation of one of the allocation of derivative income. It was noted and corrected during the year-end closing procedures, supporting documentation is attached. Additionally, ICLS is in the process of revising the Accounting Manual and will ensure that any changes related to derivative income are in accordance with 45 CFR §1630.17.

6. Fixed assets – When follow up photos were requested by OIG staff, the Controller in error did not forward one of the photos that was provided by staff. ICLS has included the original email and photo of the item evidencing the existence at the time the photo was requested. ICLS has procedures in place to track sensitive equipment that is below its fixed assets threshold, and will consider making improvements to controls and processes while updating the property and equipment section of the Accounting Manual.
7. Cost allocation – ICLS Board of Directors adopted a revised cost allocation policy effective January 1, 2018, which is attached. Corrections to costs allocations for 2018 were made in ICLS's accounting system. ICLS is in the process of incorporating the policy changes into the Accounting Manual.
8. Contracting – ICLS agrees with the recommendation that all contract agreements be written, signed and maintained. ICLS recently revised the contract policy as part of Section 9 of the Accounting Manual (see recommendation #3), and is currently in the process of reviewing all vendors, updating files and requisite purchasing documentation, and moving the files to a centralized location.
9. Contracting – See response to #8.
10. Contracting – See response to #8.
11. Written policies – ICLS is fully aware of the need to revise the Accounting Manual and to follow the recommendations in the LSC Accounting Guide. ICLS recently created a position titled Director of Training and Policy that will oversee the documentation and revision of program policies and manuals in consultation with other management personnel.
12. Internal reporting and budgeting – An overall program budget for the 2018 year was prepared by the Controller, approved by the Executive Director, and adopted by ICLS Board of Directors in March 2018, and is attached. The Accounting Manual that is currently in the process of being revised will add a new section on Budgeting that will include internal controls over the budgeting process and will be approved by the Board of Directors.

13. Internal reporting and budgeting – The Accounting Manual will be revised and the reports that are not useful to management will be removed from the manual. Approval from the Executive Director was obtained for reports that were not prepared and it was reported to the Board of Directors with no objections raised.
14. Internal reporting and budgeting – ICLS continued to have difficulty preparing monthly management financial reports timely due to a variety of factors. A new staff member was added in July 2018 to accommodate the increased work load.
15. General ledger and financial controls – ICLS agrees and has hired an additional accounting staff member to catch up.
16. General ledger and financial controls – Accounting staff is in the process of resolving old checks. The Executive Director is researching escheat rules and assisting with revising policies and procedures to ensure compliance with state laws and proper internal controls.
17. Credit cards– The Executive Director (or designee) will ensure that proper approval is attached to the credit card statement when signing checks.
18. Credit cards – The Executive Director (or designee) will also ensure that all requisite supporting documentation is attached to the credit card forms when signing the check to pay the credit card statement. Additionally, ICLS will revisit the internal controls and procedures over credit card transactions during its revision of the Accounting Manual.

Sincerely,

INLAND COUNTIES LEGAL SERVICES



Darrell K. Moore
Executive Director

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