**Office of Inspector General**
**Legal Services Corporation**

**Inspector General**
Jeffrey E. Schanz

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August 19, 2019

Mr. Brent R. Thompson
Executive Director
East River Legal Services
335 N. Main Ave, Suite 200
Sioux Falls, SD 57104

Dear Mr. Thompson:

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

The OIG considers the proposed actions to Recommendation 14 as fully responsive. This recommendation is considered closed.

The OIG considers the proposed actions to Recommendations 1, 2, 6, 9, 10, 11, 12 and 16 as responsive. However, these eight recommendations will remain open until the proposed actions have been completed and supporting documentation and the Board approved policies pertaining to Recommendations 10, 11 and 16 are provided to the OIG.

The OIG considers the proposed actions to Recommendations 3, 4, 5, 7, 8, 13 and 15 as partially responsive. The grantee did not fully address and provide a complete corrective action plan for Recommendations 3, 7 and 15. The grantee also did not provide corrective action plan specific to Recommendations 4, 5, 8 and 13. These recommendations will remain open until the OIG is provided a corrective action plan that specifically addresses the recommendations.

The OIG questioned costs totaling $11,818 of attorneys' fees that were not properly allocated to LSC in accordance with 45 CFR §1609.4. This amount will be referred to LSC management for review and action.

Please send us your response to close out the fifteen open recommendations, along with the supporting documentations within six months of the date of this final report. We thank you and your staff for your cooperation and look forward to receiving your submission by February 17, 2020.

Sincerely,

Jeffrey E. Schanz

Jeffrey E. Schanz
Inspector General

Enclosure

cc: Legal Services Corporation
Jim Sandman, President

Lynn Jennings,
Vice President for Grants Management

East River Legal Services.
Jeff Schultz, President
Sharon Chontos, Vice President

Sent by E-mail to Board of Directors
Melissa Fiksdal
Dan Fritz
Timothy Cummings
Wendy Hess
Kimberly Dorsett
James Taylor
Anthony Tessdale
Ken Teunissen
Ruth Henderson
LeeAnn No Heart

# LEGAL SERVICES CORPORATION

# OFFICE OF INSPECTOR GENERAL

# FINAL REPORT ON SELECTED INTERNAL CONTROLS

## EAST RIVER LEGAL SERVICES

### RNO 542026

Report No. AU 19-03

AUGUST 2019

www.oig.lsc.gov

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# INTRODUCTION

The Legal Services Corporation (LSC) Office of Inspector General (OIG) assessed the adequacy of selected internal controls in place at East River Legal Services (ERLS or grantee) related to specific grantee operations and oversight. Audit work was conducted at the grantee's administrative office in Sioux Falls, SD 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

East River Legal Services (ERLS) is a private nonprofit organization providing legal services to low-income persons in 33 counties in eastern South Dakota. ERLS is committed to providing high-quality, meaningful legal assistance focused on transforming the lives of its clients and community. ERLS provides legal assistance in areas including veterans' issues, family law, housing, domestic violence, older Americans, and Social Security claims.

ERLS receives funding from various sources including LSC, the South Dakota Department of Social Services, Equal Access to the Court Grant, and Minnehaha County. According to the audited financial statements for December 31, 2017, LSC provided 58 percent or $428,301 of the grantee's total funding.

## 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 ERLS' Accounting Manual and tested internal controls related to derivative income, disbursements, credit cards, fixed assets, contracting, general ledger and financial controls, cost allocation, payroll, employee benefits, and internal reporting and budgeting. While the controls for cost allocation, payroll, and employee benefits were adequately designed and properly implemented as they relate to specific grantee operations and oversight, the written policies in these areas need to be formalized. Except for general ledger and financial controls, the controls in the remaining areas need to be strengthened and formalized in writing as detailed below.

### DERIVATIVE INCOME

Written policies and procedures regarding the allocation of derivative income, including attorneys' fees and interest income, 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 attorneys' fees earned within the scope period, July 1, 2017 through September 23, 2018. There were two attorneys' fees totaling $11,818, both earned in 2017 that were not allocated according to the grantee's written methodology.

The ERLS' Accounting Manual states that derivative income will be allocated to a grant in the same proportion that the amount of the grant expended bears to the total amount expended to support the activity. Both cases were supported in whole by LSC funds and the attorneys' fees should have been fully allocated to LSC. However, a review of the grantee's audited financial statements for the year ended December 31, 2017, shows that none of the attorney's fees were allocated to LSC, but rather other funding sources.

The Director of Finance and Administration stated she was aware that the allocations for ERLS' derivative income were done incorrectly in 2017 which was before her tenure, the allocations would have to be redone for 2017 and LSC would have to be credited the amount owed. She stated she would make sure that allocations are done in accordance to the grantee's written policies and procedures moving forward.

45 CFR §1609.4(b) provides that:

> Attorneys' fees received by a recipient for representation supported in whole or in part with funds provided by the Corporation shall be allocated to the fund in which the recipient's LSC grant is recorded in the same proportion that the amount of Corporation funds expended bears to the total amount expended by the recipient to support the representation.

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

Since the attorneys' fees were not properly allocated to LSC in accordance with 45 CFR §1609.4, the OIG is questioning $11,818 of those fees. The OIG will refer the questioned costs to LSC management for review and action.

**Recommendation 1:** The Executive Director should ensure that derivative income is allocated in compliance with LSC requirements specified in 45 CFR §1609.4 and as written in the grantee's Accounting Manual.

## DISBURSEMENTS

ERLS' written policies and procedures over disbursements do not fully adhere to LSC's *Fundamental Criteria*. The OIG judgmentally selected and reviewed 50 disbursements totaling $138,614. Selected disbursements included large amounts, unfamiliar vendors, employee reimbursements, dues, memberships, conferences, training, contract services, and office supplies. OIG test work performed also found inadequate grantee practices.

### Inadequate Written Policies

The OIG reviewed the disbursement policies and procedures in ERLS' Accounting Manual and found them to be lacking details regarding:

- an outsourced accounting company's involvement in the grantee's disbursement process;
- purchases made with LSC funds above the threshold that require prior approval from LSC; and
- policies and procedures identifying and preventing conflicts of interest in the purchasing process.

The Executive Director was aware of the deficiencies and had addressed them in the new ERLS Accounting Manual approved by the ERLS Board of Directors in October 2018.

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.* LSC Regulation 45 CFR §1631.8(a) states that prior LSC approval must be obtained prior to the expenditure of more than $25,000 of LSC funds.

Written policies and procedures serve as a method to document the design of controls and adequately communicate them to the staff.

### Lack of Approvals and Requisite Documents

The OIG noted that 14 of the 50 disbursements sampled (28 percent) totaling $30,957 did not contain adequate documentation of the Executive Director's approval:

- Five disbursements totaling $19,673 had approvals dated between 1 to 5 days after issuance of the checks.

- Eight disbursements totaling $11,128 had signed approvals, but the approvals were not dated.
- One disbursement totaling $156 had no documented approval.

The OIG also found that 16 of the 50 disbursements sampled (32 percent) totaling $17,161 did not have a requisite payment voucher attached as required by the grantee's Accounting Manual.

The Executive Director stated he was not aware that dating the approvals was necessary. He stated that he occasionally missed documenting approvals but that he checked each invoice. Although the grantee's Accounting Manual requires the preparation of a payment voucher for each non-payroll disbursement, the Executive Director stated that the payment vouchers were not used due to inadvertent omission.

The LSC Accounting Guide 3-5.4 states approvals should be required at an appropriate level of management before making a commitment of resources. The ERLS Accounting Manual states a payment voucher must be prepared for every non-payroll payment. These vouchers are to be reviewed and signed by the Executive Director or Administrator before a check is prepared.

Without proper documentation of purchase approvals, it is difficult to determine whether transactions have been subjected to a thorough and timely review by management prior to disbursement of funds. Also, without payment vouchers, disbursements may not be adequately documented, and the records may not indicate the business purpose of the purchase or the proper account to which the transaction should be recorded. This may lead to inappropriate allocation of expenses to LSC.

Checks Issued Out of Sequence

The OIG's testwork revealed that from July 1, 2017 to September 23, 2018, the grantee issued 35 checks out of sequence. These checks totaled $39,769 and were issued to 15 different vendors. The OIG did not find that any checks were missing.

The Director of Finance and Administration stated that checks were issued out of sequence due to ERLS' use of an outsourced accounting firm to process checks. She stated that some checks for installment payments or recurring transactions were processed by the accounting firm simultaneously but postdated. She also stated that some checks were issued out of sequence due to time constraints and having to immediately process checks onsite rather than waiting for the outsourced accounting firm.

The Accounting Guide Appendix II stipulates that all disbursements must be made with prenumbered checks and used in numerical sequence.

Checks written out of sequence complicate the tracking of checks, including those that are still outstanding. This can delay the timely detection of duplicate or fraudulent checks. Also, checks issued out of sequence can result in cash being improperly disbursed or recorded.

**<u>Recommendations</u>:** The Executive Director should:

**<u>Recommendation 2:</u>** update the grantee's <u>Accounting Manual</u> to include details on the process for receiving prior approval from LSC for purchases exceeding $25,000 of LSC funds, the grantee's current practice regarding the use of a third-party accounting service, and policies and procedures for avoiding conflicts of interest in the purchasing process.

**<u>Recommendation 3:</u>** ensure timely review and approval of all transactions before funds are disbursed and that the reviews are dated.

**<u>Recommendation 4:</u>** ensure that grantee practices involving payment vouchers are in accordance with written policies and that voucher forms are adequately prepared for each requisite disbursement.

**<u>Recommendation 5:</u>** ensure that checks are issued sequentially and not postdated.

## CREDIT CARDS

The OIG judgmentally selected and reviewed 51 credit card transactions totaling $16,952. Selected transactions included large amounts, unfamiliar vendors, dues, memberships, conferences and training. During interviews with ERLS staff and through test work performed, the OIG found the following inadequate practices.

<u>LSC Unallowable Purchases</u>

One of the 51 credit card transactions sampled that was partially allocated to the LSC grant was found to be unallowable based on LSC regulations. The credit card transaction of $193 to the Sioux Falls Chamber of Commerce was a payment for membership dues. Of this amount, $89 was allocated to LSC funds.

The payment of $89 allocated to LSC for membership dues is unallowable by LSC regulation.

LSC Regulation 45 CFR § 1630.7(a) states that LSC funds may not be used to pay membership dues or fees to any private or nonprofit organization, whether on behalf of the recipient or an individual.

The Director of Finance and Administration stated that the unallowable purchases would be reallocated to other funding sources. The OIG determined that due to the immateriality of the amount, the proposed action to reallocate the purchases to other funding sources was adequate and would resolve the issue.

Inadequate knowledge of LSC regulations can result in the use of funds for unallowable purposes.

Inadequate Approval Documentation

Three credit card transactions totaling $1,036 did not contain adequate documentation of the Executive Director's approval. These transactions had signed approvals dated three to four months after the date of the purchase.

The Executive Director stated he was not aware that dating the approvals was necessary and that he occasionally missed documenting approvals but checked each invoice.

The LSC Accounting Guide 3-5.4 states approvals should be required at an appropriate level of management before making a commitment of resources.

The lack of full documentation of purchase approvals leaves open the question of whether transactions have been subjected to a thorough and timely review by management before funds have been disbursed.

Lack of Requisite Documents

The OIG found that 13 of the 51 transactions sampled (25 percent) totaling $2,851 did not have a requisite payment voucher attached as required by the grantee's Accounting Manual.

The Executive Director stated that the lack of payment vouchers was due to inadvertent omission.

The ERLS Accounting Manual states that a payment voucher must be prepared for every non-payroll payment. These vouchers are to be reviewed and signed by the Executive Director or Administrator before a check is prepared.

Without payment vouchers, disbursements may not be adequately documented, and the records may not indicate the business purpose of the purchase and the proper account to which the transaction should be recorded. This may lead to inappropriate allocation of expenses to LSC and errors in the general ledger.

User Agreement Forms Not in Use

There was no indication that all ERLS credit card users had read, signed, and agreed to the terms of the ERLS Credit Card Use Policy.

There are two credit card users at ERLS, the Executive Director, in whose name both cards are issued, and the Director of Finance and Administration. The Director of Finance and Administration makes purchases on websites using an online account in which the ERLS credit card is saved as the default payment method.

While the Executive Director has signed a User Agreement Form, the Director of Finance and Administration had not.

The Director of Finance and Administration did not consider herself a credit card user and did not realize she should sign a User Agreement Form.

The ERLS Accounting Manual states that before any employee can use an ERLS credit card, the employee must read, sign, and thereby agree to the terms of the ERLS Credit Card Use Policy.

Properly controlling use and documenting the issuance of credit cards through written policies and sound record keeping practices reduces the potential for misuse and protects the grantee's assets.

**Recommendations:** The Executive Director should:

**Recommendation 6:** ensure that staff is trained to recognize LSC unallowable expenses and that LSC funds are not used to pay disallowed membership dues and fees.

**Recommendation 7:** ensure all transactions are approved before a commitment of resources is made and provide adequate documentation of the date of review to ensure approvals are made on a timely basis.

**Recommendation 8:** ensure voucher forms are adequately prepared for each requisite transaction.

**Recommendation 9:** enforce the grantee's current policy requiring a written agreement for each current credit card user.

## FIXED ASSETS

Written Policies and Procedures

OIG's review of ERLS' written policies and procedures over fixed assets determined there were some policies that need to be updated to fully adhere to LSC's *Fundamental Criteria*. ERLS' Accounting Manual lacked guidance on the disposal of fixed assets, including those that may contain sensitive information and did not identify the person responsible for the tagging of inventory.

The Director of Finance and Administration stated that she did not know the Accounting Manual required that level of detail.

LSC Regulation 45 CFR §1631.12 sets forth the procedures for the disposal of personal property purchased with LSC funds. The LSC Accounting Guide Section 2-2.4 states that the recipient should be mindful of items that may contain sensitive information and the need to inventory these items and dispose of them appropriately. The LSC Accounting Guide Section 3-5.12 states that the recipient's accounting manual should document the individual responsibility for the timeliness and accuracy of each procedure.

Written policies and procedures serve as a method to document the design of controls and adequately communicate them to the staff. Furthermore, confidential client or personnel information may be improperly disclosed.

Implicit, unwritten delegations of authority can lead to misunderstandings and inefficient operations.

<u>Inadequate Property Records</u>

The OIG reviewed ERLS' property records and found that they lacked several criteria required by the <u>Accounting Guide</u>. The property records did not contain:

- Model of manufacturer's serial number or other identification number;
- Date of acquisition;
- Number of the check used to pay for the item;
- Cost of the property and salvage value;
- Useful life;
- Depreciation method;
- Source of funds used to acquire the property;
- Description of how value was assigned, if property was donated;
- Locations of each item;
- Condition of the property and the date the information was reported; and
- Ultimate disposition of items.

The Executive Director and the Director of Finance and Administration acknowledged awareness that the records were incomplete.

The <u>Accounting Guide</u> Appendix II stipulates the information that should be included in the grantee's property records.

Failure to maintain adequate property records may result in the inability to fully account for fixed asset purchases, depreciation amounts and property asset balances; and can leave assets vulnerable to undetected misappropriation.

The OIG also noted during interviews and testwork that the grantee's independent public accountant (IPA) maintained a property record used in the preparation of the grantee's audited financial statements. This record contained information such as date of acquisition, cost of the property, useful life, depreciation method, and disposition information. However, this record contained the following errors:

- Two items labeled as desktops in this record were actually laptops.
- Six laptops were aggregately listed as one server.
- Four items were listed as having been disposed of but were still in use at ERLS.

The Executive Director stated an asset management team was hired to dispose of electronic items that were obsolete or broken. However, adequate records of most items were not maintained. While the asset management team was working with the grantee's IPA to prepare the financial statements for 2017, items were removed from the property records and mistakes were made. The Executive Director could not explain why some items were listed improperly on the property records and stated that the errors were primarily made by a previous management team.

The Accounting Guide Section 2-2.4 stipulates that the grantee should be mindful of items that may contain sensitive information, items with values lower than $5,000, as well as the need to inventory these items and dispose of them appropriately. It also states that 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. Any differences between quantities determined by the physical inspection and those shown in the accounting records should be investigated to determine the cause(s) of the differences. The accounting records should be reconciled to the results of the physical inventory with an appropriate note included in the financial statements, if determined to be material by the grantee's auditor.

Failure to maintain adequate property records could result in difficulty in accounting for and tracking property. Inadequate records could also result in items being lost or stolen without management's knowledge. Also, without an adequate and complete record for all electronic items, there is no assurance that the grantee is properly safeguarding the equipment and information contained therein.

**Recommendations:** The Executive Director should:

**Recommendation 10:** ensure that the ERLS Accounting Manual is updated to provide policies and procedures governing the disposal of fixed assets including those that may contain sensitive information and the delegation of responsibility for tagging inventory.

**Recommendation 11:** ensure that the information required by the Accounting Guide is added to the property records. This information should include the check number, fair value if donated, method of valuation if donated, funding sources, identification or serial numbers, location, condition of the property and date reported, ultimate disposition data including date and method of disposal or sales price if sold. All information should be verified as accurate.

**Recommendation 12:** ensure that the property records are updated with accurate and complete information and that a physical inventory is conducted and reconciled with the property records.

## CONTRACTING

Inadequate Contracting Practice

Based on interviews, the OIG determined that the grantee's contracting practice does not fully compare to the *Fundamental Criteria*. The process used for each contract action is not fully documented and the documentation is not maintained in a central file. Sole-source contract decisions are not documented and maintained in the contract file.

In addition, the grantee's practice also does not adhere to its written policy that states a written evaluation must be performed for items over $1,000 and under $10,000.

The Executive Director stated there had been some deficiencies regarding contracts in the past and that they were working to improve the process. He recognized that the same vendors were used for several years but stated that they were working on new Requests for Proposals.

The LSC *Fundamental Criteria* Section 3-5.16 states that the process used for each contract action should be fully documented and the documentation maintained in a central file. Any deviations from the approved contracting process should be fully documented, approved, and maintained in the contract file. In addition, the statement of work should be sufficiently detailed so that contract deliverables can be identified and monitored to ensure completeness. Documents to support competition should be retained and kept with contract files.

Contracting is a high-risk area for potential abuse and fraud. Without adequate policies and procedures over all types of contracts, the contracting process may result in the waste of scarce funds and subject the grantee to questioned costs and proceedings.

<u>Inadequate Contracting Documentation</u>

The OIG selected a non-statistical sample of eight vendors and tested them for compliance with the *Fundamental Criteria*. According to the grantee's check register, these eight vendors were paid a total of $169,793 during the audit scope period. To select our sample, we requested consultant contracts and/or agreements involving disbursements during the audit period. In response to our request, the grantee provided two contracts. In addition, we reviewed the check register and selected five additional vendors with whom we believed the grantee should have had a contract, such as those with large transaction amounts and multiple payments. Lastly, while on-site, the grantee provided a supplementary folder which contained contracts that had not been previously presented or considered. We selected one additional contract from that folder.

The purpose of our sample was not to project the results to the intended universe or to generalize about the universe.

Two of the eight contracts were competitively bid and six were sole-sourced. Sole-sourced contracts are contracts established without a competitive process and require justification that only one known source exists or that only a single vendor can fulfill the requirements.

The OIG noted inadequate contracting documentation as follows:

- None of the eight contracts totaling $169,793 had documentation of the process used for each contract action on file. In addition, the bid documentation that was provided was not centrally filed with the contracts.
- Six of the eight contracts with payments totaling $74,006 had no documentation of sole-source justification on file.
- One of the eight contracts with payments totaling $23,381 did not detail the total contract amount, billing rate, or payment terms.

- One of the eight contracts with payments totaling $27,467 did not detail the payment terms. The contract had a price of $360 but the contract did not specify the payment terms or the frequency of payments. In addition, the invoiced amounts were higher than the price on the contract. The invoiced amounts were $699. The Director of Finance and Administration stated that she believed the price on the contract was a monthly rate.
- One contract's cost cap and expiration date were exceeded. According to the contract, the total payment amount was not to exceed $5,000 and the contract was to expire on December 31, 2017 or when the payment exceeded $5,000. However, we noted that the total amount paid to the vendor was $5,303, and five payments were made in 2018. The Executive Director stated that he had explicitly instructed the external accounting firm to notify him when the contract was up and was not aware ERLS had reached the cap amount of $5,000.

In general, the Executive Director stated there had been some deficiencies regarding contracts in the past and they are working to improve the process. He fully recognized that certain issues were a result of maintaining multiple vendors for a number of years. He stated that the grantee will review current contracts to determine if the contract should be rebid to ensure the best price and service available. The Executive Director and the Director of Finance and Administration both stated that the contracts were not as detailed as they should have been and agreed to review them to ensure the information is accurately detailed.

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

The ERLS Accounting Manual states that a written evaluation must be performed if items are over $1,000 and under $10,000.

Contracting is a high-risk area for potential abuse and fraud. Without adequate policies and procedures over all types of contracts, the contracting process may result in the waste of scarce funds and subject the grantee to questioned costs and proceedings.

**Recommendations:** The Executive Director should ensure that:

**Recommendation 13:** contracts are written, signed and maintained for all business arrangements. The contracts should fully document the agreed upon cost, payment, and other terms and should be reviewed periodically to ensure that written terms are defined and current.

**Recommendation 14:** the process for each contract action is fully documented in writing such as sole source justification and documentation of competition, if competitively bid.

**Recommendation 15:** a 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, and any agreed upon modifications to a contract or agreement.

## WRITTEN POLICIES

The OIG's review noted that the procedures and practices covering cost allocation, payroll, employee benefits, and internal reporting and budgeting were adequate; however, the written policies for these areas need to be enhanced as follows:

| AREA | CONDITION | EFFECT | CRITERIA |
|---|---|---|---|
| **Cost Allocation** | The cost allocation methodology in practice did not fully correspond with the policies and methodology stated in the grantee's Accounting Manual. The manual did not provide a detailed description of the allocation procedures, when they are performed or state that the allocations are performed by the external accounting firm. | Without a detailed written description of the cost allocation procedures, there could be a lack of transparency and consistency in the application of the methodology, especially in cases of staff turnover. | The Accounting Guide states that 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. |
| **Payroll** | The grantee's Accounting Manual states that the Administrator prepares payroll and is also responsible for entering all pay and deduction changes, including new employees, into the payroll records. However, in practice, the grantee outsources the payroll to be processed by a contracted accounting firm, which eliminates the lack of segregation of duties. The grantee should update their written policies to reflect their practice. | Written policies and procedures serve as a method to document the design of controls and adequately communicate them to the staff. | Per Section 3-4.5 of LSC's *Fundamental Criteria*, each recipient must develop a written Accounting Manual that describes the specific procedures to be followed by the recipient in complying with the *Fundamental Criteria*. |

| AREA | CONDITION | EFFECT | CRITERIA |
| --- | --- | --- | --- |
| **Employee Benefits** | The employee benefits policies did not outline that the grantee offers a retirement 401K plan to their employees. | Written policies and procedures serve as a method to document the design of controls and adequately communicate them to staff. Without detailed written procedures over employee benefits, there could be a lack of transparency and consistency in the distribution of the benefits. | Per Section 3-4.5 of LSC's *Fundamental Criteria,* each recipient must develop a written Accounting Manual that describes the specific procedures to be followed by the recipient in complying with the *Fundamental Criteria*. |
| **Internal Reporting and Budgeting** | The internal reporting and budgeting policies in the grantee's Accounting Manual did not state that the Executive Director receives monthly management reports. The policies also did not detail that an outsourced accounting firm generates the quarterly and yearly reports and provides them to the Director of Finance and Administration, who in turn reviews them for accuracy before submitting to the Executive Director, the Audit Committee and the Board of Directors. | Written policies and procedures serve as a method to document the design of controls and adequately communicate them to the staff. | Per Section 3-4.5 of LSC's *Fundamental Criteria,* each recipient must develop a written Accounting Manual that describes the specific procedures to be followed by the recipient in complying with the *Fundamental Criteria*.<br><br>The Accounting Guide Section 3-5.9 states that the director should receive a monthly management report within a prescribed number of days after month-end. |

The Director of Finance and Administration 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.

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 16:** The Executive Director should ensure written policies and procedures in the areas of cost allocation, payroll, employee benefits, and internal reporting and budgeting are included within the grantee's Accounting Manual. They should adequately describe the processes and controls in sufficient detail, and in accordance with LSC's Accounting Guide and *Fundamental Criteria.* They should also reflect the current staff assigned to specific duties.

## GRANTEE MANAGEMENT COMMENTS

Grantee management agreed with all the findings and the16 recommendations contained in the report. Grantee management stated the following:

- ERLS indicated that they have taken action to ensure derivative income is allocated in compliance with LSC requirements as specified in 45 CFR §1609.4 and as written in their Accounting Manual.
- ERLS updated its Accounting Manual to include details on the process for receiving prior approval from LSC for purchases exceeding $25,000 of LSC funds, the grantee's current practice regarding the use of a third-party accounting service, and policies and procedures for avoiding conflicts of interest in the purchasing process. ERLS stated that they have instituted a new operations manual that includes their conflict of interest policy and requires all staff and members of the ERLS Board of Directors to execute a conflict disclosure statement.
- ERLS indicated concurrence with the recommendation to ensure timely review and approval of all transactions before funds are disbursed and stated that all transaction approvals are now dated.
- ERLS indicated concurrence with the recommendation to issue checks sequentially and not postdate them.
- ERLS plans to further improve the administration of the program by establishing a formal training program for the ERLS Board of Directors and administration staff. ERLS indicated that they will continue to engage in discussions with stakeholders as one of many vehicles for identifying areas where additional guidance and improvement may be appropriate.
- ERLS indicated that all users of the company credit card now sign a written agreement.
- ERLS updated its Accounting Manual to include details on the disposal of fixed assets and tagging assets and inventory.
- ERLS indicated that the Accounting Manual has been updated to ensure the information required by the Accounting Guide is added to the property records and that all information has been verified as accurate.
- ERLS stated that a new physical inventory was conducted, which was reconciled with property records. The ERLS fixed asset policy states that inventory is now regularly maintained with more specificity.
- ERLS indicated concurrence with the recommendation to ensure contracts are written, signed and maintained for all business arrangements and that contracts should fully document the agreed upon cost, payment, and other terms and should be reviewed periodically to ensure that written terms are defined and current.
- ERLS revised the Accounting Manual to include details on the required documentation for all purchases including contracts
- ERLS stated that all contracts are maintained in the Director of Finance and Administration office.

- ERLS revised its Accounting Manual which included revisions for mandatory protocols and procedures creating better oversight and safeguards against fraud or mistake. Accounting functions are now spread out across the program.

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

## OIG EVALUATION OF GRANTEE MANAGEMENT COMMENTS

The OIG considers the proposed actions for Recommendation 14 as fully responsive and closed. The grantee responded to Recommendation 14 by stating that the revised Accounting Manual includes the required documentation for all purchases including contracts.

The OIG considers the proposed actions to Recommendations 1, 2, 6, 9, 10, 11, 12 and 16 as responsive. The grantee management's planned actions to address the issues and update the policies and procedures pertaining to derivative income, credit cards, fixed assets, cost allocation, employee benefits should correct the issues identified in the report. However, these recommendations will remain open until the OIG is notified in writing that the proposed actions have been completed and the supporting documentations are provided.

Recommendation 1 will remain open until the OIG is provided documentation supporting compliance with regulation 45 CFR §1609.4.

Recommendation 2 will remain open until the OIG is provided the new Operations Manual documenting their conflict of interest policy.

Recommendation 6 will remain open until the OIG is informed in writing that staff have been trained to recognize LSC unallowable expenses and that LSC funds are not used to pay disallowed membership dues and fees was provided.

Recommendation 9 will remain open until the OIG is provided a copy of the signed written agreement for each current credit card user.

Recommendation 10 will remain open until the OIG is provided with the updated and Board approved fixed asset policy. The updated manual should include policies and procedures governing the disposal of fixed assets including those that may contain sensitive information and the delegation of responsibility for tagging inventory.

Recommendation 11 will remain open until the OIG is provided with an updated and Board approved Accounting Manual that ensures the information required by the Accounting Guide is added to the property records; and notified in writing that the information on the property records has been verified as accurate.

Recommendation 12 will remain open until the OIG is provided with evidence of the most recent inventory conducted and a copy of the complete property records.

Recommendation 16 will remain open until the OIG is provided with the updated and Board approved policies related to cost allocation and employee benefits.

The OIG considers the proposed actions for Recommendation 3,4,5,7,8,13 and 15 as partially responsive.

The grantee responded to Recommendation 3 by stating that all transactions approvals are now dated; however, they did not address how the grantee will ensure timely review and approvals of all transactions before funds are disbursed. This recommendation will remain open until the OIG is provided support or written documentation on how the grantee will ensure timely review and approvals of all transactions before funds are disbursed.

The grantee responded to Recommendation 4 by stating their concurrence with the recommendation and that all transactions approvals are now dated. However, the recommendation is to ensure that grantee practices involving payment vouchers are in accordance with written policies and that vouchers are adequately prepared for each requisite disbursement, which the grantee did not address. Recommendation 4 will remain open until the OIG is provided a corrective action plan that specifically addresses the recommendation such as support or written documentation on how the grantee will ensure that their practices involving payment vouchers are in accordance with written policies and that voucher forms are adequately prepared for each requisite disbursement.

The grantee responded to Recommendation 5 by stating their concurrence with the recommendation; however, they did not address how the grantee will ensure that checks are issued sequentially and not postdated. Recommendation 5 will remain open until the OIG is provided a corrective action plan that specifically addresses the recommendation such as support or written documentation on how they will ensure that checks are issued sequentially and not postdated.

The grantee responded to Recommendation 7 by stating that all transaction approvals are now dated before a commitment of resources are made; however, they did not address how the grantee will ensure all transactions are approved before a commitment of resources are made. This recommendation will remain open until the OIG is provided support or written documentation on how the grantee will ensure all transactions are approved before a commitment of resources are made.

The grantee responded to Recommendation 8 by stating their concurrence with the recommendation and that all transaction approvals are now dated; however, the recommendation is to ensure voucher forms are adequately prepared for each requisite transaction, in which the grantee did not address. Recommendation 8 will remain open until the OIG is provided a corrective action plan that specifically addresses the recommendation such as support or written documentation on how the grantee will ensure voucher forms are adequately prepared for each requisite transaction.

The grantee responded to Recommendation 13 by stating their concurrence with the recommendation. However, grantee management did not address how they will ensure all contracts are written, signed and maintained for all business arrangements. They also did not address how the grantee will ensure that contracts fully document agreed upon costs, payments, and other terms and how they will review contracts periodically to ensure that written terms are defined and current. Recommendation 13 will remain open until the OIG is provided a corrective action plan that specifically addresses each of these elements.

The grantee responded to Recommendation 15 by stating that all contracts are maintained in the Director of Finance and Administration office. However, the grantee did not address pertinent documents and other contract related processes. This recommendation will remain open until the OIG is provided with a corrective action plan that relates to pertinent contract documents, the solicitation of bids, including receipt and evaluation of bids, sole source justification, vendor selection, a signed contract or agreement, and any agreed upon modifications to a contract or agreement.

The OIG questioned costs totaling $11,818 of attorneys' fees that were not properly allocated to LSC in accordance with 45 CFR §1609.4. This amount will be referred to LSC management for review and action.

**APPENDIX I**

## SCOPE AND METHODOLOGY

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

- Disbursements;
- Credit Cards;
- Contracting;
- Cost Allocation;
- Derivative Income;
- General Ledger and Financial Controls;
- Internal Reporting and Budgeting;
- Fixed Assets;
- 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.

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 50 disbursement transactions totaling $138,614. The sample represented approximately 32 percent of the $436,490 disbursed for expenses other than payroll during the period July 1, 2017, to September 23, 2018. Because the samples were non-statistically selected, we did not project results and conclusions to the entire population. 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 51 credit card transactions totaling $16,952 was judgmentally selected. Because the samples were non-statistically selected, we did not project results and conclusions to the entire population. 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, 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. The OIG 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 scope of the audit was July 1, 2017 through September 23, 2018. We conducted on-site fieldwork for the audit from September 24, 2018 through September 28, 2018. Audit work was conducted at the grantee's administrative office in Sioux Falls, SD and at LSC headquarters in Washington, DC.

We previously conducted an on-site visit at the grantee's administrative office from October 30, 2017 through November 3, 2017. During that visit, we reviewed documents pertaining to the, period July 1, 2016 through June 30, 2017. At the end of that visit, we summarized the results of our work in a letter issued to management. We do not rely on the results of that work for this audit.

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.

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July 11, 2019

Legal Services Corporation Office of Inspector General
333 K Street, NW, 3rd floor
Washington DC, 20007-3558

RE: ERLS' response and comments to the open recommendations

Greetings:

**Recommendation 1: The Executive Director should ensure that derivative income is allocated in compliance with LSC requirements specified in 45 CFR §1609.4 and as written in the grantee's Accounting Manual.**

ERLS concurs with the above recommendation and has taken action to ensure compliance.

**Recommendation 2: update the grantee's Accounting Manual to include details on the process for receiving prior approval from LSC for purchases exceeding $25,000 of LSC funds, the grantee's current practice regarding the use of a third-party accounting service, and policies and procedures for avoiding conflicts of interest in the purchasing process.**

ERLS concurs with the above recommendation and has updated its accounting manual. We have also instituted a new operations manual which states our conflict of interest policy and requires all staff and members of the ERLS board of Directors to execute a conflict disclosure statement.

**Recommendation 3: ensure timely review and approval of all transactions before funds are disbursed and that the reviews are dated.**

ERLS concurs with the above recommendation. All transaction approvals are now dated.

**Recommendation 4: ensure that grantee practices involving payment vouchers are in accordance with written policies and that voucher forms are adequately prepared for each requisite disbursement.**

ERLS concurs with the above recommendation. All transaction approvals are now dated.

**Recommendation 5: ensure that checks are issued sequentially and not postdated.**

ERLS concurs with the above recommendation.

**Recommendation 6: ensure that staff is trained to recognize LSC unallowable expenses and that LSC funds are not used to pay disallowed membership dues and fees.**

ERLS concurs with the above recommendation. ERLS plans to further improve the administration of the

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program by establishing a formal training program for the ERLS Board of Directors and administration staff. We will continue to engage in discussions with stakeholders as one of many vehicles for identifying areas where additional guidance and improvement may be appropriate.

**Recommendation 7: ensure all transactions are approved before a commitment of resources is made and provide adequate documentation of the date of review to ensure approvals are made on a timely basis.**

ERLS concurs with the above recommendation. All transaction approvals are now dated.

**Recommendation 8: ensure voucher forms are adequately prepared for each requisite transaction.**

ERLS concurs with the above recommendation. All transaction approvals are now dated.

**Recommendation 9: enforce the grantee's current policy requiring a written agreement for each current credit card user.**

ERLS concurs with the above recommendation. All users of the company credit card now sign a written agreement.

**Recommendation 10: ensure that the ERLS Accounting Manual is updated to provide policies and procedures governing the disposal of fixed assets including those that may contain sensitive information and the delegation of responsibility for tagging inventory.**

ERLS concurs with the above recommendation. The Accounting Manual has been updated regarding disposal of fixed assets and tagging assets and inventory.

**Recommendation 11: ensure that the information required by the Accounting Guide is added to the property records. This information should include the check number, fair value if donated, method of valuation if donated, funding sources, identification or serial numbers, location, condition of the property and date reported, ultimate disposition data including date and method of disposal or sales price if sold. All information should be verified as accurate.**

ERLS concurs with the above recommendation. The ERLS Accounting Manual has been updated to ensure the information required by the Accounting Guide is added to the property records and that all information has been verified as accurate.

**Recommendation 12: ensure that the property records are updated with accurate and complete information and that a physical inventory is conducted and reconciled with the property records.**

ERLS concurs with the above recommendation. Since the audit ERLS has conducted a new physical inventory, which has been reconciled with property records. Per ERLS policy, the inventory is now regularly maintained with more specificity.

**Recommendation 13: contracts are written, signed and maintained for all business arrangements. The contracts should fully document the agreed upon cost, payment, and other terms and should be reviewed periodically to ensure that written terms are defined and current.**

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ERLS concurs with the above recommendation.

**Recommendation 14: the process for each contract action is fully documented in writing such as sole source justification and documentation of competition, if competitively bid.**

ERLS concurs with the above recommendation. The new ERLS Accounting Manual requires documentation for all purchases including contracts.

**Recommendation 15: a 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, and any agreed upon modifications to a contract or agreement.**

ERLS concurs with the above recommendation. All contracts are maintained in the Director of Finance and Administration Office.

**Recommendation 16: The Executive Director should ensure written policies and procedures in the areas of cost allocation, payroll, employee benefits, and internal reporting and budgeting are included within the grantee's Accounting Manual. They should adequately describe the processes and controls in sufficient detail, and in accordance with LSC's Accounting Guide and Fundamental Criteria. They should also reflect the current staff assigned to specific duties.**

ERLS concurs with the above recommendation. ERLS has dramatically revised its Accounting Manual, which was approved in October of 2018. These revisions created mandatory protocols and procedures creating better oversight and safeguards against fraud or mistake. Accounting functions are now spread out across the programs Executive Director, Director of Finance and Administration, the ERLS Audit and Finance Committee, external bookkeeping service, and the ERLS Board of Directors.