Office of Inspector General
Legal Services Corporation

January 12, 2021

Ms. DarKenya Waller
Executive Director
Legal Aid Society of Middle Tennessee and the Cumberlands
1321 Murfreesboro Pike
Suite 400
Nashville, TN 37217

Dear Ms. Waller,

Enclosed is the Legal Services Corporation (LSC) Office of Inspector General's (OIG) final report for our Audit on selected internal controls at Legal Aid Society of Middle Tennessee and the Cumberlands (LAS). Appendix III of the final report includes LAS' comments to the draft report in their entirety.

The OIG considers the proposed actions to Recommendations 8 and 16 as fully responsive and considers these two recommendations closed.

The OIG considers the proposed actions to Recommendations 1, 6, 7, 9, 11, 13 14, 15, 17 and 18 as responsive. The grantee management's planned actions to address the issues and update the policies and procedures pertaining to derivative income, general ledger and financial controls, contracting, disbursements, cost allocation, credit cards, fixed assets, and 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 documentation is provided.

The OIG considers the implemented actions for Recommendations 2 through 5, 10, and 12 as partially responsive. The grantee did not provide an action plan specific to the recommendations. These recommendations will remain open until the OIG is notified in writing the specific action plan and provided supporting documentation that addresses the recommendations.

The OIG is referring questioned costs totaling $49,022 to LSC Management for review and action. Due to an oversight, this amount was improperly classified from the sale of a property in which LSC had reversionary interest.

Please send us your response to close out the 16 open recommendations, along with supporting documentation within six months of the date of the final report. We thank you and your staff for your cooperation and look forward to receiving your submission by July 12, 2021.

Sincerely,

Jeffrey E. Schanz

Jeffrey E. Schanz

Enclosure

cc: Legal Services Corporation
Ron Flagg, President

Lynn Jennings
Vice President for Grants Management

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LEGAL SERVICES CORPORATION

OFFICE OF INSPECTOR GENERAL

FINAL REPORT ON SELECTED INTERNAL CONTROLS

LEGAL AID SOCIETY OF MIDDLE TENNESSEE AND THE CUMBERLANDS

RNO 643040

Report No. AU 21-02

January 2021

www.oig.lsc.gov

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INTRODUCTION

The Legal Services Corporation (LSC) Office of Inspector General (OIG) assessed the adequacy of selected internal controls in place at Legal Aid Society of Middle Tennessee and the Cumberlands, related to specific grantee operations and oversight. Audit work was conducted at the grantee's administrative office in Nashville, TN and LSC headquarters in Washington, DC.

In accordance with the Accounting Guide for LSC Recipients (2010 Edition) (LSC Accounting Guide), Chapter 3, an LSC grantee is required to establish and maintain adequate accounting records and internal control procedures. The LSC Accounting Guide defines internal control as follows:

> The 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 LSC 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

Legal Aid Society of Middle Tennessee and the Cumberlands (LAS or "grantee") is a non-profit organization that provides legal assistance in non-criminal proceedings. LAS' mission is to advance, defend and enforce the legal rights of low-income and vulnerable people in order to secure for them the basic necessities of life. LAS is Tennessee's largest non-profit law firm, serving 48 counties in Tennessee.

According to the audited financial statement report for fiscal year ending 2018, LAS received a total of $8,769,172 in funding. LSC provided approximately 44 percent or $3,329,082 of the grantee's revenue, excluding $1,149,717 in donated services.

OBJECTIVE

The overall objective was to assess the adequacy of select internal controls at LAS and determine whether costs were supported and allowed under the LSC Act of 1974 as amended, and the Accounting Guide for LSC Recipients, as well as other applicable laws and regulations.

AUDIT FINDINGS

To accomplish the audit objective, the OIG evaluated select internal controls in specific financial and operational areas to ensure that costs were adequately supported and allowed under the LSC Act, along with other LSC regulations and guidelines. In particular, the OIG reviewed and tested internal controls related to disbursements, credit cards, contracting, cost allocation, derivative income, general ledger and financial controls, management reporting and budgeting, fixed assets, employee benefits, payroll, and client trust funds within the audit period of January 1, 2018 to December 31, 2019.

Internal controls were adequately designed and properly implemented in management reporting and budgeting, and payroll, as they relate to specific grantee operations and oversight. However, LAS needs to implement minor improvements to strengthen its practices and formalize, in writing, internal controls over derivative income, general ledger and financial controls, contracting, disbursements, cost allocation, credit cards, fixed assets, employee benefits, as detailed below.

DERIVATIVE INCOME

The OIG reviewed LAS' derivative income processes to determine whether adequate internal controls exist over derivative income and whether derivative income is properly recorded and allocated according to LSC regulations and guidelines.

LAS' derivative income written policies and procedures were reasonable and adhered to LSC regulations and guidelines. However, in one instance, due to an oversight, the grantee failed to properly classify $49,022 of income derived from the sale of a property in which LSC had interest.

Misclassification of LSC Derivative Income

In 2018, LAS sold a property for $96,973 in which LSC held full reversionary interest. The entire amount should have been classified as LSC derivative income. However, the grantee's financial statements for the fiscal year ending 2018 disclosed only $47,951 as LSC derivative income. The remaining amount of $49,022 was classified as miscellaneous income and not attributed to LSC.

An Approval for Sale Agreement between LSC and the grantee was signed by both parties in April 2018 in which LSC granted approval to the grantee to sell the property on the condition that LAS treat 100 percent of the sale proceeds as LSC derivative income.

45 CFR § 1630.17(a) states:

> Derivative income resulting from an activity supported in whole or in part with LSC funds shall be allocated to the fund in which the recipient's LSC grant is recorded in the same proportion that the amount of LSC funds expended bears to the total amount expended by the recipient to support the activity.

Additionally, 45 CFR § 1631.21 (b) states:

> The recipient must account for income earned from the sale, rent, or lease of real or personal property purchased with LSC funds according to the requirements of 45 CFR 1630.17.

The Director of Finance said that they only classified $47,951 as LSC derivative income based on her understanding of the instructions provided by LSC.

While the grantee is now aware of the error and has stated they are taking action to ensure the full $96,973 is classified as LSC derivative income, we are questioning the misclassified amount of $49,022, pursuant to 45 CFR § 1630.17(a) and 45 CFR § 1631.21(b).

Proper classification of derivative income allows LSC to be accorded its apportioned share of income, which in turn can be used to provide legal services in accordance with LSC requirements.

The Executive Director should:

Recommendation 1: ensure that the proceeds of the property sold in 2018 for which LSC held a full reversionary interest are properly classified as LSC derivative income in accordance with LSC guidance.

GENERAL LEDGER AND FINANCIAL CONTROLS

The OIG reviewed LAS' written policies and procedures over the general ledger and financial controls and found that they were compliant with the *Fundamental Criteria*.

During interviews and test work, we noted checks outstanding for more than six months, bank reconciliations not performed on all accounts, bank reconciliations not reviewed, and a lack of segregation of duties over access to the accounting system.

Checks Outstanding More Than Six Months

LAS had multiple checks outstanding for more than six months. As of the September 30, 2019 operating account statement, 90 checks were outstanding, totaling $26,642. While on site, we were able to verify that accounting staff was in the process of clearing these outstanding checks subsequent to the September 2019 statement.

LAS' Accounting & Financial Policies and Procedures Manual, Section 5, states, "Any outstanding checks in transit over six months old should be reviewed for disposition. This periodic review should determine the status of the outstanding checks." Additionally, the LSC Accounting Guide, Appendix VII, Section I.7, suggests that checks outstanding for more than six months should be investigated and resolved.

The Director of Finance stated she was aware that outstanding checks should be investigated but had fallen behind due to conflicting obligations. She had begun clearing the checks, but not all of them have been resolved.

Not monitoring and resolving outstanding checks timely may result in undetected fraudulent signatures or alterations of checks and could result in an inaccurate bank balance.

Bank Reconciliations Not Performed

Four of the 32 accounts reviewed did not have statements for the months selected. Bank reconciliations were not performed in 24 of the 28 applicable accounts tested. The accounts that were not reconciled included investment, payroll and client trust accounts.

The LSC Accounting Guide, Section 3-5.2(d), states, "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."

The Director of Finance stated that some accounts were not formally reconciled because there was minimal activity in the accounts.

Without proper reconciliation procedures, irregular activity and recording errors may not be detected on a timely basis.

Bank Reconciliations Not Performed Timely

LAS prepared bank reconciliations for 4 of the 28 applicable accounts we reviewed. One of the four reconciliations was not prepared timely. It was prepared approximately six months after the statement date.

LAS' Accounting & Financial Policies and Procedures Manual, Section 5, states, "All bank account statements must be reconciled with the cash balances presented in the accounting records (General Ledger) as of the end of each month. Bank reconciliations are to be prepared on a monthly basis within 30 days after the bank statements are received from the bank."

Based on our interviews and testwork, we determined that the reconciliation was not prepared timely due to conflicting work priorities.

Without proper reconciliation procedures, irregular activity and recording errors may not be detected on a timely basis.

Bank Reconciliations Not Reviewed

During our review, we noted that the operating and checking account reconciliations performed by the accounting contractor did not show evidence of review by the Executive Director, Deputy Director of Operations, or Director of Finance.

The LSC Accounting Guide, Section 3-5.2(d), states, "The reconciliation shall be reviewed and approved by a responsible individual. Such review shall be appropriately documented by signature and date." Further, LAS' Accounting & Financial Policies and Procedures Manual, Section 5, states, "The bank reconciliation reports should be carefully reviewed by the Executive Director or Deputy Director of Operations, and such review should be appropriately documented by signature and date."

The Director of Finance stated that she recently realized the need to review the reconciliations performed by the contractor and had begun doing so.

Timely review of bank reconciliations can reduce the likelihood of undetected reconciliation errors.

Lack of Segregation of Duties

The OIG found a lack of segregation of duties in the accounting system. The Director of Finance, Director of Human Resources, and accounting contractor all had full access rights to the system. Additionally, all fiscal department staff had edit access to the cash receipts log, including the individual responsible for transporting deposits to the bank.

The LSC Accounting Guide, Section 3-4.3, states:

> Accounting duties should be segregated to ensure that no individual simultaneously has both the physical control and the recordkeeping responsibility for any asset. Duties must be segregated so that no individual can initiate, execute, and record a transaction without a second independent individual being involved in the process.

The Director of Finance stated that she and the Director of Human Resources used to be the only users of the accounting system and both had full access so that duties could be covered in case one of them was absent. The accounting contractor was later added as a backup for the Director of Finance.

The Director of Finance was unaware that multiple users were able to edit the cash receipts log. She stated that access rights would be changed so that only the individual responsible for recording receipts would be able to edit.

Inadequate segregation of duties within the accounting system can lead to users conducting actions in the system that are not applicable to their specific accounting responsibilities and can result in failure to prevent and detect error, fraud, theft, and collusion.

The Executive Director should:

Recommendation 2: ensure that all checks outstanding for more than six months are investigated and cleared per the grantee's written policy and LSC guidance.

Recommendation 3: ensure that investment and client trust accounts are reconciled at least once annually if the account activity is minimal, and the payroll account is reconciled monthly.

Recommendation 4: ensure that the grantee's policies are followed, and bank reconciliations are performed timely each month.

Recommendation 5: ensure that operating account reconciliations are reviewed, and that such review is documented.

Recommendation 6: update the user rights for both the accounting system and cash receipts log so that the accounting staff have access based on their roles and responsibilities.

CONTRACTING

To test internal controls over contracting, we conducted interviews and selected a sample of eight contracts for services including information technology, accounting, strategic planning, public relations, training, and communications. During the scope of the audit, vendors in the sample were paid a total of $359,768. In general, LAS followed its written policies and complied with LSC regulations. However, we noted a missing contract, missing support for competitive and sole-source procurements, and a lack of contracts for janitorial services.

Missing Contract

LAS was unable to locate one contract for accounting system support. The vendor was paid a total of $9,100 during the scope of the audit.

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."

The Deputy Director of Operations stated the contract pre-dated his tenure, so he was unsure why one was not on file. He agreed that a contract should be established.

Proper documentation helps ensure that the grantee followed all established contracting procedures. Without a contract on file, it may be difficult to know if the grantee received the agreed-upon services.

Missing Support

LAS did not provide evidence of competition or sole-source justification for two contracts in our sample. Additionally, the contracts were long standing; one established in 2005, the other in 2013, and documentation of re-evaluation was not available. The vendors were collectively paid $20,299 during the scope of the audit.

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." Additionally, LSC Program Letter 16-3: Procurement Policy Drafting 101, Section III, states, "Although it is beneficial to establish long-lasting business relationships with reliable vendors, it is important to periodically recompete recurring purchases and long-standing contracts every 3 to 5 years to ensure that best value is obtained."

The Deputy Director of Operations stated that one of the contracts initially started as a volunteer arrangement more than 20 years ago. Eventually, LAS began making payments at a discounted rate. Regarding the second contract, he was unsure why documentation was not kept showing bids or sole-source justification, as the contract pre-dated his tenure.

Proper documentation helps ensure that the approved contract has followed all established procedures. Periodically re-evaluating contracts ensures that the greatest value is obtained.

Janitorial Services Not Contracted

LAS historically did not require that formal contracts be established with janitorial service providers.

The LSC Accounting Guide, Section 3-5.16, states, "The statement of work should be sufficiently detailed so that contract deliverables can be identified and monitored to ensure that the deliverables are completed."

The Deputy Director of Operations stated that contracts were not used for janitorial service providers due to the low dollar amounts involved and the frequency of change in providers. Beginning in January 2020, LAS began establishing contracts with janitorial service providers.

Without a detailed and documented statement of work, it may be difficult to ensure that LAS receives the services agreed to.

The Executive Director should:

Recommendation 7: ensure that the arrangement with the accounting system support provider is formally documented in a contract.

Recommendation 8: ensure that evidence of contract competition or sole-source justifications are maintained in a central file. Additionally, contracts should be re-bid or re-evaluated every three to five years.

Recommendation 9: ensure that the recently initiated practice of establishing contracts with janitorial service providers is implemented in all applicable offices.

DISBURSEMENTS

The OIG found that LAS' written policies regarding disbursements were comparable to LSC's *Fundamental Criteria*. Through interviews and test work, we found that the grantee was not consistently following their established practices and the Accounting & Financial Policies and Procedures Manual did not fully reflect the actual practices in place. Additionally, voided checks were not processed according to the described practice. For testing, we initially selected a random sample of 100 disbursements; then we applied a judgmental methodology to arrive at a final sample of 93 transactions totaling $269,090. We also judgmentally selected 10 voided checks totaling $138,930. In the course of our review, we found the following:

Inconsistent Prior Approvals

During our review, we found 13 disbursements for which no approval was evident prior to payment. These totaled $95,345, of which $47,600 was charged to LSC.

In addition, LAS had established purchase orders as the method of documenting approval prior to initiation of cash disbursements that were not reimbursements or recurring in nature. However, our test work showed they were not used consistently for applicable purchases. Two disbursements totaling $288 did not have corresponding purchase orders.

The LSC Accounting Guide, Section 3-5.4, states, "Approval should be required at an appropriate level of management before a commitment of resources is made." We determined that the purchase orders were not used due to oversight.

Failure to follow the purchase approval process may result in purchases made without the knowledge of appropriate management or at unacceptable prices or terms.

Update Written Policies

The grantee's written policies did not always reflect the actual practices concerning cash disbursements. The Director of Finance had developed a Litigation Approval Form to document prior approval for litigation expenses greater than $150; additionally, check requests were not always required for invoices processed through the grantee's accounts payable system. These practices were not documented in LAS' Accounting & Financial Policies and Procedures Manual.

The LSC Accounting Guide, Section 3-4(5), states, “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*.”

OIG review determined the grantee enacted the aforementioned practices for oversight and efficiency reasons but overlooked the need to formally establish them in written policies.

Implicit, unwritten delegations of authority and “understood” criteria often lead to misunderstandings and less-than-efficient operations.

Checks Not Voided According to Policy

Test work showed that checks were not always voided according to the grantee’s written policies and described practice. In the sample of 10 voided checks, one was not filed with a Void Check Form, and six were filed without supporting documentation.

LAS’ Accounting & Financial Policies and Procedures Manual states, “A voided check form along with the voided checks and supporting documentation shall be maintained in a voided check folder.”

The Director of Finance stated that the checks may have been voided immediately due to an error in the printing. In these cases, the check would have been reprinted and supporting documentation filed with the disbursed check. The Director of Finance stated that Void Check Forms were not filed due to oversight.

Inconsistent application of policies and procedures could result in inefficient use of program resources.

The Executive Director should:

Recommendation 10: ensure that purchase orders are used for all applicable cash disbursements, and that approval is documented for all disbursements prior to payment.

Recommendation 11: ensure that LAS’ written policies are updated to reflect the current practices in place over cash disbursements, including the Litigation Approval Form and the non-requirement of check requests for recurring invoices.

Recommendation 12: ensure that the grantee’s written policies are followed, and that voided checks are filed with appropriate forms and documentation.

COST ALLOCATION

The OIG reviewed LAS’ cost allocation processes to determine whether adequate internal controls exist over cost allocation and whether the allocation methodology is reasonable and in compliance with LSC regulations and guidelines.

The OIG found that LAS’ cost allocation methodology was reasonable and adhered to LSC regulations and guidelines. However, the grantee’s policies did not fully describe the methodology.

Inadequate Written Procedures Over Cost Allocation

LAS' written policies and procedures over cost allocation did not accurately describe its methodology for the allocation of rent, utilities, maintenance, and housekeeping expenses. In practice, the grantee allocated these indirect expenses by utilizing a calculated occupancy rate which was then billed to the various funding sources based on the number of employees at each office as well as their time charged to the grants. However, this process was not included in the grantee's Accounting & Financial Policies and Procedures Manual.

Additionally, the grantee's policies stated that administrative costs are allocated using a base that results in equitable distribution. Through testing and interviews we found that administrative costs were allocated among the funding sources in proportion to the revenue from allocable grants on the monthly budgets. However, the grantee's method for allocating these costs and the base used was not elaborated on in the Accounting & Financial Policies and Procedures Manual.

The LSC Accounting Guide, Section 3-5.9, states that the allocation formula should be adequately documented in writing with enough detail for an auditor and other relevant parties, to easily understand, follow and test. Section 3-4 states that "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."*

The Director of Finance was not aware that this level of detail was required.

A lack of detailed procedures for allocating costs increases the risk of unallowable costs being charged to LSC.

The Executive Director should:

Recommendation 13: ensure detailed written procedures over the allocation of indirect costs, including the calculation and application of occupancy costs are included in the grantee's Accounting & Financial Policies and Procedures Manual.

Recommendation 14: ensure the Accounting & Financial Policies and Procedures Manual is updated to provide clarity on the allocation of administrative costs, including the allocation base and how allocations are calculated.

CREDIT CARDS

The OIG reviewed LAS' credit card policies and procedures to determine whether LAS had internal controls in place over the use of credit cards. To determine if credit card transactions were adequately supported, properly approved, and in accordance with LSC regulations and guidelines, we judgmentally selected and reviewed 44 transactions from four credit card statements, totaling $20,885. Of this amount, $5,735 was charged to LSC.

LAS had 14 credit cards in use, with each card having an individual limit of $5,000. There was also a bank imposed $50,000 limit across all LAS issued credit cards in aggregate.

Interviews and test work found that the credit cards were used primarily for travel and training, recurring services, bar dues, supplies, and computer purchases, among other expenses.

Our test work revealed that transactions were adequately supported, reasonable, and allowable per LSC regulations. However, there were no credit card user acknowledgement agreements and no supervisory review of credit card statements.

No Credit Card User Agreement Forms

LAS did not create or utilize a Credit Card User Agreement for employees who are issued and authorized to use credit cards. A Credit Card User Agreement Form is a form established wherein an authorized credit card user accepts and agrees to abide by the grantee's policies and procedures over the use of credit cards.

The LSC Accounting Guide, Appendix VII, advises grantees to develop a form containing relevant credit card policies for employees who are issued and authorized to use credit cards to review and sign.

The Deputy Director of Operations explained that they had not considered such a form but would be amenable to instituting one.

The lack of a signed user agreement may result in confusion over the initiation, approval, and use of credit cards. Also, a signed credit card user agreement demonstrates that authorized card holders have read the credit card policies and procedures and are responsible for knowing and adhering to the policies.

Lack of Executive Director Review

While the grantee had policies and procedures in place for supervisory review of credit card transactions, there was no practice or policy for Executive Director review of the credit card statements before submission to the person(s) responsible for final transaction review and recording into the General Ledger.

The LSC Office of Compliance and Enforcement made a recommendation to LAS in its September 2016 *Compliance Review Report* that stated "as a best practice, that the Executive director review all credit card statements before they are submitted to the person(s) responsible for final transaction review and recording into the G/L [General Ledger]." In addition, the LSC Accounting Guide, Appendix VII, advises timely review of payment of credit card charge accounts to validate disbursements.

The Executive Director felt that the grantee's current process of review and reconciliation was adequate. Without a high-level review of credit card transactions, the grantee may expend funds on impermissible or unnecessary expenses.

The Executive Director should:

Recommendation 15: develop a credit card user agreement form for authorized credit card holders and users to read, acknowledge and sign. The agreement may include, but not be limited to, repayment terms and conditions for personal use or misuse of the card. The signed agreement should be retained in a central file.

Recommendation 16: review all credit card statements before they are submitted to the Director of Finance for final transaction review and recording into the General Ledger.

FIXED ASSETS

The OIG found that LAS' written policies regarding fixed assets were comparable to LSC's *Fundamental Criteria*. However, the grantee's Accounting & Financial Policies and Procedures Manual stated, "All physical inventories will be periodically counted and reviewed on a frequent basis and under a common set of procedures and controls." This does not specifically address the LSC *Fundamental Criteria* requirement to conduct an inventory every two years.

Physical Inventory Not Conducted Every Two Years

Interviews and test work found that the grantee was not consistently following the LSC *Fundamental Criteria* by not conducting an inventory every two years as required, with the last physical inventory conducted in 2017.

Failure to conduct inventory on fixed assets may result in the inability to identify missing assets, thereby not properly tracking potential theft or disposal of assets.

The Accounting Guide 2-2.4 states:

> 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 shall be investigated to determine the causes of the difference, and 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 recipient's auditor.

The Executive Director should:

Recommendation 17: ensure that a physical inventory is conducted in 2020 and in subsequent two-year cycles, and that the Accounting & Financial Policies and Procedures Manual is updated to reflect the two-year inventory requirement.

EMPLOYEE BENEFITS

LAS offered a standard package of employee benefits, including paid leave, health insurance, flexible spending accounts, bar exam reimbursements, cell phone reimbursements, and attorney loan repayments. We found that, for the most part, LAS equitably offered the benefits to all employees and the written policies and procedures for employee benefits appear to comply with the *Fundamental Criteria* in the LSC Accounting Guide. However, the cell phone reimbursement policy was not communicated to employees and the criteria for reimbursements were not clearly defined in the policies.

Ambiguous Cell Phone Reimbursement Policy

LAS had a policy in which they agreed to pay a reasonable part of an employee's monthly cell phone fee if the device had been used during the month for LAS business. However, the policy did not provide details regarding the procedures to be followed to request reimbursement, the supporting documentation required for reimbursement, or the amount permitted to be reimbursed.

The policies also stated that submission of a bill by a staff member is certification that the device has been used during the month for LAS business. However, the policies did not establish guidelines on how to determine if the device had actually been used for LAS business or if the amount of reimbursement requested was reasonable. We found that two LAS employees were using the benefit and received a total of $1,200 in reimbursements over the scope of the audit.

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

The Director of Human Resources was unaware there was a written cell phone reimbursement policy and stated that LAS staff was probably unaware of the policy as well. The Deputy Director of Operations stated, the policy was originally created by a previous Executive Director and, except for use by a few employees, the policy had been largely forgotten.

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.

The Executive Director should:

Recommendation 18: either eliminate the cell phone reimbursement policy or update the policy to include details concerning the specific procedures to be followed to request reimbursements, the required supporting documentation, and the amount to be reimbursed.

OIG SUMMARY OF GRANTEE MANAGEMENT COMMENTS

LAS provided their responses to the OIG's Draft Report via email on December 3, 2020. LAS' responses are included in their entirety in Appendix III.

LAS management agreed with all 18 recommendations and stated that they:

- will reclassify their opening LSC net assets in their Fiscal Year 2020 audited financial statements to add the proceeds of a property sold in 2018 for which LSC held full reversionary interest.
- hired an accounting clerk in October 2020 to assist with accounting activities.
- contracted with a company to review their accounting system and modify the accounting system access.
- created a shared electronic file to store contract documentation in one location
- are implementing janitorial contracts.
- updated their accounting manual to ensure written policies are updated to reflect current practices.
- implemented a credit card user agreement form for all credit card holders.
- created a shared electronic file for the Director of Finance to upload monthly credit card statements for the Executive Director's review.
- are conducting a physical inventory in 2020.
- modified the cell phone expense reimbursement policy in response to the remote work needed by the coronavirus disease 2019 (COVID-19) pandemic.

OIG EVALUATION OF GRANTEE MANAGEMENT COMMENTS

The OIG considers the grantee's comments and actions for Recommendations 8 and 16 as fully responsive and the two recommendations are considered closed.

- For Recommendation 8, the grantee created a central computer file to store appropriate contract documentation and have uploaded all contracts into the file.

- For Recommendation 16, the grantee created a central computer file to store monthly credit card statements for the Executive Directors review, and plan on ensuring all approvals are completed before they are recorded in the general ledger.

The OIG considers the proposed actions to Recommendations 1, 6, 7, 9, 11, 13, 14, 15, 17 and 18 as responsive. The grantee management's planned actions to address the issues or update the policies and procedures pertaining to derivative income, general ledger and financial controls, contracting, disbursements, cost allocation, credit cards, fixed assets, and 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 documentation is provided.

- The OIG accepts the grantee's stated actions for Recommendation 1 related to reclassification of reversionary interest. However, this recommendation will remain open until the OIG is provided with a copy of their Fiscal Year 2020 Independent Public Accountant prepared financial statements. The OIG is referring questioned costs totaling $49,022 to LSC Management for review and action. Due to the grantee's oversight, this amount was improperly classified from the sale of a property in which LSC had reversionary interest.

- Recommendation 6 will remain open until the OIG is provided with updated user rights for both the accounting system and cash receipts log.

- Recommendations 7 and 9 will remain open until the OIG is provided with the signed vendor contracts for JourneyTeam and the janitorial services.

- Recommendations 11 will remain open until the OIG is provided with the updated Board approved Accounting and Financial Policies and Procedures Manual documenting the current practices in place over cash disbursements, the Litigation Approval Form and the non-requirement of check requests for recurring invoices

- Recommendations 13 and 14 will remain open until the OIG is provided with the updated Accounting & Financial Policies and Procedures Manual that contains detailed written procedures for cost allocation.

- Recommendation 15 will remain open until the OIG is provided with the implemented and signed credit card user agreement forms.

- Recommendation 17 will remain open until the OIG is provide with the 2020 inventory records.

- Recommendation 18 will remain open until the OIG is provided with the modified cell phone reimbursement policy and notice of the cancellation of policy scheduled to end December 31, 2020.

The OIG considers the implemented actions for Recommendations 2 through 5, 10, and 12 as partially responsive. The grantee responded to these recommendations by stating that they hired an accounting clerk in October 2020 to assist with accounting activities. However, for:

- Recommendation 2, they did not address how the accounting clerk will ensure timely review and escheating of outstanding checks. Recommendation 2 will remain open until the OIG is provided with the most recent two months of bank reconciliations showing that there are no more checks outstanding for more than six months prior to the date of the report.

- Recommendation 3 and 4, they did not address how the accounting clerk will ensure timely reconciliations of investment, client trust, and payroll accounts. Recommendation 3 and 4 will remain open until the OIG is provided with an annual investment and client trust account reconciliations for 2020, and a copy of a recent monthly payroll account reconciliation.

- Recommendation 5, they did not address how the accounting clerk will ensure that operating account reconciliations are reviewed, and how such review is documented. Recommendations 4 and 5 will remain open until the OIG is provided with three most recent operating account bank reconciliations along with documented evidence of Executive Director review.

- Recommendation 10, they did not address how the accounting clerk will ensure that purchase orders are used for all applicable cash disbursements, and that approval is document for all disbursements prior to payment. Recommendation 10 will remain open until the OIG is provided with a written plan or policy that addresses the need for documented and preapproved purchase orders.

- Recommendation 12, they did not address how the accounting clerk will ensure that the grantee’s written policies are followed, and that voided checks are filed with appropriate forms and documentation. Recommendation 12 will remain open until the OIG is provided with evidence that ensures the grantees written policies are followed, and that voided checks are filed with appropriate documentation.

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
- Management Reporting and Budgeting
- Fixed Assets
- Employee Benefits
- Payroll
- Client Trust Funds

The OIG 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 during the period of January 1, 2018 through December 31, 2019.

To obtain an understanding of the internal control framework and LAS' processes over areas listed above, we (1) reviewed grantee's policies and procedures, including manuals, guidelines, memoranda and directives, setting forth current grantee practices, and (2) interviewed grantee management and staff.

To review and evaluate internal controls, the OIG designed and performed audit procedures to obtain sufficient and appropriate evidence to support conclusions over the design, implementation, and operating effectiveness of controls significant to the audit objective. Furthermore, we conducted direct tests, including inquiry, observation, examination, and inspection of source documents to determine whether the grantee's internal control system and policies and procedures complied with the guidelines in the *Fundamental Criteria of an Accounting and Financial Reporting System* (*Fundamental Criteria*) contained in the Accounting Guide for LSC Recipients.

In accordance with government auditing standards, the OIG assessed the reliability of LAS' computer-generated data. To determine whether the data is reasonably complete, accurate and consistent, we reviewed supporting documentation, conducted interviews, performed logical tests, traced to and from source documents, and reviewed selected system controls. The OIG determined the data as sufficiently reliable for the purposes of this report.

We also assessed significance and audit risk. The OIG determined that internal controls in select financial and operational areas mentioned above were significant to the audit objective. Audit risk is defined as the possibility that audit findings, conclusions, recommendations or assurance may be improper or incomplete as a result of factors such as, evidence that is not sufficient or appropriate, an inadequate audit process, or intentional omissions or misleading information because of misrepresentation or fraud. Based on our consideration of these factors, we determined the audit risk level to be low.

A non-statistical sampling methodology was used to select samples for testing. We determined that a non-statistical methodology would be appropriate based on the audit objective, scope, nature of the grantee and audit timeline. Our results cannot be projected to the universe and are not intended to make inferences about the populations from which our samples were derived.

To test for the appropriateness of expenditures and the existence of adequate supporting documentation, we reviewed disbursements from a sample of vendor files. We initially used a simple random methodology to select 100 disbursement transactions from the check register. From these, we judgmentally removed transactions with low values. We then judgmentally selected large and small transactions to arrive at a final sample of 93 disbursements totaling $269,090. This represented approximately six percent of the $4,779,580 disbursed for transactions other than credit cards and payroll during the period January 1, 2018 through December 31, 2019. To assess the appropriateness of expenditures, we reviewed invoices and supporting documentation, then traced the expenditures to the general ledger. The appropriateness of those expenditures was evaluated based on the grant agreements, applicable laws and regulations and LSC policy guidance.

In addition to the disbursements, we selected 44 transactions, totaling $20,885, from four credit card statements. We assessed the appropriateness of the expenditures and the existence of approvals and adequate supporting documentation.

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

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

Controls over the purchase, inventory, disposal, and recording of property and equipment were reviewed by examining current grantee practices in comparison with LSC regulations and policies outlined in the Accounting Guide for LSC Recipients.

The on-site fieldwork was conducted from February 3, 2020 through February 12, 2020. Our work was conducted at the grantee's administrative office in Nashville, TN and at LSC headquarters in Washington, DC. Documents reviewed pertained to the period January 1, 2018 through December 31, 2019.

The audit was conducted in accordance to generally accepted government auditing standards. Those standards require that the audit be planned and performed to obtain sufficient, appropriate evidence to provide a reasonable basis for findings and conclusions based on the audit objective. The OIG believes the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objective. We assessed internal controls and compliance with laws and regulations necessary to satisfy the audit objective. In particular, we assessed the internal control components and underlying principles that we determined to be significant to the audit objective as shown in Appendix II – Assessment of Internal Control Components and Principles. However, because our review was limited to these internal control components and underlying principles, it may not have disclosed all internal control deficiencies that may have existed at the time of this audit.

Additionally, the OIG assessed whether it is necessary to evaluate information systems controls. The OIG determined that information system controls are significant to the audit objective and evaluated information system controls related to specific grantee operations, oversight, program expenditures, and fiscal accountability. Our internal control review includes performing audit procedures related to information system controls to obtain sufficient, appropriate evidence to support and document our findings and conclusions on implementation and effectiveness of internal control at the grantee. We determined that no further audit procedures relating to information systems controls were needed.

APPENDIX II – ASSESSMENT OF INTERNAL CONTROL COMPONENTS AND PRINCIPLES

Table 1 – Internal Control Principles Significant/Material to the Audit Objective[1]

Internal Control Component		Principle	
Name	**Overview**	**Number**	**Description**
Control Environment	The control environment is the foundation for an internal control system. It provides the discipline and structure, which affect the overall quality of internal control. It influences how objectives are defined and how control activities are structured. The oversight body and management establish and maintain an environment throughout the entity that sets a positive attitude toward internal control.	2	The Oversight Body Should Oversee the Entity's Internal Control System
		3	Management Should Establish an Organizational Structure, Assign Responsibility, and Delegate Authority to Achieve the Entity's Objectives
Control Activities	Control activities are the actions management establishes through policies and procedures to achieve objectives and respond to risks in the internal control system, which includes the entity's information system.	10	Management Should Design Control Activities to Achieve Objectives and Respond to Risks
		11	Management Should Design the Entity's Information System and Related Control Activities to Achieve Objectives and Respond to Risks
		12	Management Should Implement Control Activities Through Policies

[1] The numbers correspond with the principles outlined in the *Standards for Internal Control in the Federal Government* (GAO-14-704G). While principles 1, 4, 5, 6, 7, 8, 9, 16 and 17 were considered during the audit, these principles were determined not to be significant to the audit objective.

Internal Control Component		Principle	
Name	**Overview**	**Number**	**Description**
INFORMATION AND COMMUNICATION	Management uses quality information to support the internal control system. Effective information and communication are vital for an entity to achieve its objectives. Entity management needs access to relevant and reliable communication related to internal as well as external events.	13	Management Should Use Quality Information to Achieve the Entity's Objectives
		14	Management Should Internally Communicate the Necessary Quality Information to Achieve the Entity's Objectives
		15	Management Should Externally Communicate the Necessary Quality Information to Achieve the Entity's Objectives

Legal Aid Society of Middle Tennessee & the Cumberlands

50 YEARS

Working Together. Doing Justice. Restoring Hope.

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Recommendation Tracking

Grantee Name: Legal Aid Society of Middle Tennessee and the Cumberlands

RNO: 643040

The Office of Inspector General makes recommendations for actions or changes that will correct problems, better safeguard the integrity of funds, and improve procedures or otherwise increase efficiency or effectiveness. We believe grantee management understands its operations best and is in a position to utilize more effective methods to respond to our recommendations. We encourage these methods when responding to recommendations.

Instructions: Please complete this form with your comments and select whether you agree, partially agree, or disagree with the recommendations outlined in the draft report. Along with this form, submit a letter outlining your responses to our audit report.

Recommendations	Response	Comments
Recommendation 1: Ensure that the proceeds of the property sold in 2018 for which LSC held a full reversionary interest are properly classified as LSC derivative income in accordance with LSC guidance.	Agree ☒ Partially Agree ☐ Disagree ☐	Kraft CPAs (IPA) will make a reclassification into the opening LSC net assets in the FY 2020 audit to add the proceeds of the property sold in 2018 for which LSC held a full reversionary interest.
Recommendation 2: Ensure that all checks outstanding for more than six months are investigated and cleared per the grantee's written policy and LSC guidance.	Agree ☒ Partially Agree ☐ Disagree ☐	In progress. LAS hired an accounting clerk in October 2020 to assist with this activity.
Recommendation 3: Ensure that investment and client trust accounts are reconciled at least once annually if the account activity is minimal, and the payroll account is reconciled monthly.	Agree ☒ Partially Agree ☐ Disagree ☐	In progress. LAS hired an accounting clerk in October 2020 to assist with this activity.
Recommendation 4. Ensure that the grantee's policies are followed, and bank reconciliations are performed timely each month.	Agree ☒ Partially Agree ☐ Disagree ☐	In progress. LAS hired an accounting clerk in October 2020 to assist with this activity.
Recommendation 5. Ensure that operating account reconciliations are reviewed, and that such review is documented.	Agree ☒ Partially Agree ☐ Disagree ☐	In progress. LAS hired an accounting clerk in October 2020 to assist with this activity.
Recommendation 6. Update the user rights for both the accounting system and cash receipts log so that the accounting staff have access based on their roles and responsibilities.	Agree ☒ Partially Agree ☐ Disagree ☐	Cash receipts log restricted according to staff roles and responsibilities in November 2020. Accounting system is being reviewed and access is being modified by contractor, JourneyTeam. Estimated completion date: January 1, 2021.
Recommendation 7. Ensure that the arrangement with the accounting system support provider is formally documented in a contract.	Agree ☒ Partially Agree ☐ Disagree ☐	JourneyTeam contract has been requested as of November 9, 2020
Recommendation 8. Ensure that evidence of contract competition or sole-source justifications are maintained in a central file. Additionally, contracts should be re-bid or reevaluated every three to five years.	Agree ☒ Partially Agree ☐ Disagree ☐	Complete. Contract folder created on SharePoint to store appropriate documentation and contracts have been and continue to be uploaded in real time.
Recommendation 9. Ensure that the recently initiated practice of establishing contracts with janitorial service providers is implemented in all applicable offices.	Agree ☒ Partially Agree ☐ Disagree ☐	Janitorial contracts being collected and stored on SharePoint. Estimated completion date: January 31, 2021.

Recommendation 10. Ensure that purchase orders are used for all applicable cash disbursements, and that approval is documented for all disbursements prior to payment.	Agree ☒ Partially Agree ☐ Disagree ☐	In progress. LAS hired an accounting clerk in October 2020 to assist with this activity.
Recommendation 11. Ensure that LAS' written policies are updated to reflect the current practices in place over cash disbursements, including the Litigation Approval Form and the non-requirement of check requests for recurring invoices.	Agree ☒ Partially Agree ☐ Disagree ☐	Complete. Accounting Manual updated as of December 7, 2020.
Recommendation 12. Ensure that the grantee's written policies are followed, and that voided checks are filed with appropriate forms and documentation.	Agree ☒ Partially Agree ☐ Disagree ☐	In progress. LAS hired an accounting clerk in October 2020 to assist with this activity.
Recommendation 13. Ensure detailed written procedures over the allocation of indirect costs, including the calculation and application of occupancy costs are included in the grantee's Accounting & Financial Policies and Procedures Manual.	Agree ☒ Partially Agree ☐ Disagree ☐	In progress. Director of Finance and Grants Manager updating written procedures. Estimated completion date: January 31, 2021.
Recommendation 14. Ensure the Accounting & Financial Policies and Procedures Manual is updated to provide clarity on the allocation of administrative costs, including the allocation base and how allocations are calculated.	Agree ☒ Partially Agree ☐ Disagree ☐	In progress. Director of Finance and Grants Manager updating written procedures. Estimated completion date: January 31, 2021.
Recommendation 15. Develop a credit card user agreement form for authorized credit card holders and users to read, acknowledge and sign. The agreement may include, but not be limited to, repayment terms and conditions for personal use or misuse of the card. The signed agreement should be retained in a central file.	Agree ☒ Partially Agree ☐ Disagree ☐	Credit card user agreement form was sent to all credit card holders on November 30, 2020. All have been signed and returned and in a folder on SharePoint.
Recommendation 16. Review all credit card statements before they are submitted to the Director of Finance for final transaction review and recording into the General Ledger.	Agree ☒ Partially Agree ☐ Disagree ☐	Complete. Created a folder on SharePoint for Director of Finance to upload monthly credit card statements for Executive Director's review. Automatic notifications are sent when changes occur, such as when a statement is uploaded and when it is approved. All approvals are completed before they are recorded in the General Ledger.
Recommendation 17. Ensure that a physical inventory is conducted in 2020 and in subsequent two-year cycles, and that the Accounting & Financial Policies and Procedures Manual is updated to reflect the two-year inventory requirement	Agree ☒ Partially Agree ☐ Disagree ☐	2020 inventory began in October 2020 and will be concluded by January 31, 2021.
Recommendation 18. Either eliminate the cell phone reimbursement policy or update the policy to include details concerning the specific procedures to be followed to request reimbursements, the required supporting documentation, and the amount to be reimbursed.	Agree ☒ Partially Agree ☐ Disagree ☐	Cell phone expense reimbursement policy was modified in response to the Remote Work Arrangement necessitated by the COVID-19 pandemic. It is currently scheduled to end on December 31, 2020. All cell phone expense reimbursement will end on that date for all staff.

Name and Title DarKenya W. Waller, Executive Director

Signature DarKenya W. Waller