Office of Inspector General
Legal Services Corporation

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March 26, 2018

Ms. Jan Chiaretto
Executive Director
Statewide Legal Services of Connecticut
1290 Silas Deane Highway
Suite 3A
Wethersfield, CT 06109

Dear Ms. Chiaretto:

Enclosed is the Office of Inspector General's (OIG) final report for our audit on Selected Internal Controls at Statewide Legal Services of Connecticut, Inc. Your comments are included in the final report as Appendix II.

The OIG considers the proposed actions to all the Recommendations as responsive. The actions planned by grantee management to address the issues and revise and update its Accounting Policies and Procedures Manual should correct the issues identified in the report.

However, Recommendations 11, 21 and 24 will remain open until the Accounting Policies and Procedures Manual has been updated and the Board of Directors approves it. Recommendations 1, 2, 7, 8, 12, 13, 17, 18, 19, 20, and 23 will remain open until further supporting documentation is provided. Recommendations 3, 4, 5, 6, 9, 10, 14, 15, 16, 22, and 25 are considered closed.

Please provide us with your response to close out the 14 open recommendations along with the revised Accounting Policies and Procedures Manual within six months of the date of this final report. We thank you and your staff for your cooperation and look forward to receiving your submission by September of 2018.

Sincerely,

Jeffrey E. Schanz

Inspector General

Enclosure

LSC
America's Partner For Equal Justice

cc: Legal Services Corporation
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LEGAL SERVICES CORPORATION

OFFICE OF INSPECTOR GENERAL

FINAL REPORT ON SELECTED INTERNAL CONTROLS

STATEWIDE LEGAL SERVICES OF CONNECTICUT, INC.

RNO 107000

Report No. AU 18-02

March 2018

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 Statewide Legal Services of Connecticut, Inc. (SLSC or grantee) related to specific grantee operations and oversight. Audit work was conducted at the grantee's administrative office in Wethersfield, CT 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

Statewide Legal Services of Connecticut, Inc. (SLSC) is a nonprofit corporation that provides legal assistance to residents of the State of Connecticut to the extent authorized by the Legal Services Corporation Act. SLSC is a telephonic intake and advocacy center committed to empowering low-income people to obtain justice by providing tools to address their civil legal needs.

SLSC receives financial assistance from various sources including LSC and Interest on Lawyers' Trust Accounts programs. According to the audited financial statements for December 31, 2016, LSC provided 81 percent or $2,886,139 of the grantee's 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 and tested internal controls related to disbursements, contracting, fixed assets, credit cards, cost allocation, derivative income, internal reporting and budgeting, general ledger and financial controls, employee benefits and payroll. While some of the controls were adequately designed and properly implemented as they relate to specific grantee operations and oversight, we found that controls in the areas detailed below need to be strengthened and/or formalized in writing.

COST ALLOCATION

SLSC's written policies and procedures for cost allocation mostly adhere to LSC's *Fundamental Criteria of an Accounting and Financial Reporting System (Fundamental Criteria)* contained in the LSC Accounting Guide. Based on grantee staff interviews and test work performed by the OIG, allocations were not always done in accordance with the grantee's documented policies and procedures.

Accounting System

SLSC is not using the "class" or funding source within its accounting system. OIG test work revealed that allocations were not performed in the grantee's QuickBooks accounting system which also resulted in the absence of an audit trail to identify funding source expenditures. Also, there were no cost allocation journal entries for the LSC OIG to verify whether cost allocations are being correctly accounted for within the financial system.

The Finance Manager stated that cost allocations are performed in a separate excel spreadsheet and that she is still learning about the accounting system and its capabilities.

LSC Accounting Guide, 3-5.8, General Ledger, (b) Design: Fund Accounting/Cost Center Accounting/Functional Accounting, stipulates that the general ledger design should accommodate fund accounting and/or cost center accounting/functional accounting and other financial requirements in accordance with the most expedient procedures in the circumstances. Also, LSC Accounting Guide, 2-5, Accounting Records, stipulates that accounting records should be maintained in an automated accounting system to provide an adequate audit trail for all transactions.

Without an audit trail, it is difficult to determine or test whether allocations are performed accurately. Also, the failure to fully incorporate fund accounting into the program's accounting system may result in an inability to document compliance with federal requirements. The reliability of management reports generated from sources other than the general ledger can be significantly impaired and the actual report preparation significantly more cumbersome.

Inconsistent Allocation Methodology

We reviewed the grantee's practices over cost allocation and found that the written formula is not consistently being followed in allocating costs to LSC. Of the five expenses tested from SLSC's cost allocation excel spreadsheet, none were allocated in accordance with a set percentage, based on the ratio of the amount of the specific grant to the total of all SLSC grant income, or apportioned between grants according to formula. In addition, we found an accrued payroll expense from 2016 totaling $107,981.85 and an accrued annual leave expense totaling $10,800.09 that were not allocated according to the written policy. Both accrued expenses were charged to LSC.

The Finance Manager stated, in general, all costs are charged to other funding sources per the approved budget and whatever is left is charged to LSC. Grants from LSC's Technology Initiative Grant and Mashantuket Pequot Tribal National are the only exceptions, and are based on the hours entered into the timekeeping system and considered as direct costs. She added that moving forward she will use the allocation formula as written in the 2017 Accounting Policies and Procedures Manual.

LSC Accounting Guide, 3-5.9, Management Reports, stipulates that common expenses shall be allocated among the sources on the basis agreed to by the applicable funding organizations. In the absence of approved methods, expenses should be allocated in a fair, consistent, and equitable manner to individual cost centers and funds. Further, the allocation formula should be adequately documented with sufficient detail for the auditor, LSC, OIG, GAO and others to easily understand, follow, and test the formula.

The allocation of costs to an activity must demonstrate the total cost of the activity that a funding source is financing. Also, without a consistent, systematic basis for allocating costs, there is no assurance that LSC and other funding sources will receive their fair and equitable share of the costs.

Recommendations: The Executive Director should:

Recommendation 1: ensure the accounting system's general ledger is designed to accommodate fund, cost or functional accounting which would allow for allocation of expenses by funding source and provide an adequate audit trail.

Recommendation 2: enforce consistency in following the written cost allocation policy including all formulas and methodology.

Recommendation 3: ensure the accounting staff obtain training on the accounting system's capabilities so staff will be able to utilize all the functions contained within the system.

CONTRACTING

SLSC's Accounting Policies and Procedures Manual in effect during the scope of our audit did not include written policies and procedures for contracting. SLSC's subsequent Accounting Policies and Procedures Manual, dated August 2017, has written policies and procedures for contracting that adhere to LSC's *Fundamental Criteria*. Several staff members were interviewed by OIG staff to obtain an understanding of the current contracting processes. We learned of some of the contracts in place and currently being bid on, and the processes being followed for those bids, etc. Based on the interviews held, SLSC staff's current practices adhere to LSC's *Fundamental Criteria*. Nevertheless, the OIG reviewed 11 existing vendor files and tested them for compliance with the *Fundamental Criteria*. Of the 11 files reviewed, inadequate contracting documentation was found, as follows:

- For one of the eleven vendors, management was unable to locate a documented contractual agreement with the vendor for the services provided. While some of the costs involved were not high dollar amounts, the business arrangements were for recurring services and therefore, the terms and price should be documented in a contractual agreement.
- For two of the eleven vendors, we were unable to determine a contractual period for the services.
- For seven of the eleven vendors, management was unable to provide supporting documentation on how the vendor was selected. Management confirmed that one was competed, one was sole sourced, and they were unsure of how the remaining five were selected.
- For six of the eleven vendors, documented proper approval, in accordance with written SLSC's policies, was not maintained.

The Finance Manager stated that many of the vendors go back prior to her tenure and, therefore, she is unable to locate some of the documentation. The Finance Manager also mentioned she believes there were bidding processes and vendors discussed with management and the Board of Directors; however, documentation was not maintained.

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

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

Recommendations: The Executive Director should ensure that in practice:

Recommendation 4: contracts for services are written, signed and maintained for all business arrangements, especially those recurring in nature. The contracts should fully document the agreed upon terms, selling price, and payment terms and should be reviewed periodically to ensure that written terms are defined and current.

Recommendation 5: 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, required approvals, and any agreed upon modifications to a contract or agreement.

Recommendation 6: the process for each contract action is fully documented in writing, such as sole source justification and documentation of competition, if competitively bid.

DISBURSEMENTS

The OIG reviewed SLSC's written policies and procedures over disbursements and found they are comparable to the *Fundamental Criteria* in the LSC Accounting Guide. Eighty-four disbursements were judgmentally selected for review and testing, comprising 79 vendors totaling $262,842. Selected transactions included unusual vendors, large payment amounts, frequent payments, potentially unallowable costs, out-of-state bar dues, rent leases, payments to consultants, employee reimbursements, and acquisitions of assets or office supplies. During the test work, some inadequate practices, approvals and documentation were found as follows:

Restrictions in the Accounting Information System (AIS)

There are inadequate electronic controls in the accounting information system to prevent errors or other misstatements. The Finance Manager and Bookkeeper have the same user rights in the accounting information system although they do not have the same responsibilities to enter, review, or approve entries.

The Finance Manager stated the IT Administrator set-up her user rights in the accounting information system when she was hired. Since then, the levels of access have not been revisited. She stated the administration of the AIS will be transferred to her eventually.

The LSC Accounting Guide Section 3-5.14, states that there should be adequate separation of duties within the electronic data processing operation. Furthermore, Section 3-4 stipulates that duties must be segregated so that no individual can initiate, execute, and record a transaction without a second independent individual being involved in the process.

Without management review and control over electronic data processing, functions and controls are readily subject to misuse. In addition, assigning both data entry and supervisory rights to users in the accounting system may increase the likelihood of fraudulent activities going undetected.

Segregation of Duties

There is no segregation of duties over the maintenance of the Master Vendor List. The Bookkeeper, who also prepares checks, can add and edit vendors without authorized approval. In addition, the list is not reviewed nor purged for inactive vendors on a scheduled basis.

The Bookkeeper stated she has been responsible for the Master Vendor List since before the arrival of the Finance Manager. However, she stated the Finance Manager reviews all disbursements prior to the Bookkeeper preparing check batches. The Finance Manager agreed with the Bookkeeper, but stated she will take over the Master Vendor List maintenance to implement adequate segregation of duties.

The LSC Accounting Guide Section 3-4.3, stipulates that accounting duties should be segregated to ensure that no individual simultaneously has both physical control and record keeping for any asset, including but not limited to, cash, client deposits, supplies, and property. Duties must be segregated so that no individual can initiate, execute, and record a transaction without a second independent individual being involved in the process.

Without adequate segregation of duties between the accounts payable function and the maintenance of the master vendor list, the grantee may not be able to detect unauthorized changes to vendor information which may lead to fraud, waste or abuse of the grantee’s resources.

Inadequate Approval

Of the 84 disbursements which included 110 individual transactions reviewed, 22 transactions, totaling $58,038 were missing appropriate approvals.

- 18 invoices, totaling $54,023, contained no documented approvals nor dates of approvals; therefore, the OIG could not determine if the appropriate approval had been obtained prior to the disbursement of funds.
- Four of the transactions, totaling $4,015, were credit card purchases missing pre-requisite approvals per SLSC's Credit Card policy; therefore, they also were not in accordance with the grantee's policies and procedures.

The Finance Manager stated she began noting invoices as "OK to pay" about a few months ago, therefore some invoices may be missing her initial approval and date of approval. She stated she will begin initialing and dating all her approvals.

The LSC Accounting Guide Section 3-5.4, stipulates that approval should be required at an appropriate level of management before a commitment of resources is made. Furthermore, Appendix VII, prescribes that transactions in the accounting records should be properly authorized, as evidenced by supporting documentation containing the appropriate approving official's signature. In addition, SLSC's Accounting Policies and Procedures Manual states that all invoices and employee reimbursement requests, when received, must be dated and then forwarded to the Finance Manager for review and approval. When approved, the invoice/expense request will be forwarded to the Bookkeeper for processing.

Failure to follow the purchase approval process may result in purchases being made without the knowledge of appropriate management or at unacceptable prices or terms. In addition, approvals should be dated. Otherwise, it is difficult to ascertain if expenditures were timely approved before a commitment of resources was made.

Duplicate Check Numbers

OIG test work identified duplicate check numbers paid to two different vendors on different dates. The Bookkeeper explained the check issued on 01/20/17 was an EFT and the check issued on 06/21/17 was a pre-numbered check. Upon review of the supporting documentation, this was found to be accurate.

The *Fundamental Criteria,* Section 3-5.4(b), stipulates that all disbursements (other than petty cash) should be made by pre-numbered checks. However, the OIG recognizes the various payment solutions offered by current technology and the advantages associated with these alternative methods of payment to the grantee. As provided by Chapter 3-4 of the LSC Accounting Guide, the grantee must establish independent checks and proofs consisting of regular internal verification of the recording of transactions, including verifying the check sequence and voided checks prior to a check run. This may apply to electronic data processing and electronic system controls to provide an additional level of assurance for information integrity.

An ineffective method for initially recording disbursements may adversely affect the ability to accurately report actual expenses to management. Inadequate document control may result in duplicate payments.

Recommendations: The Executive Director should ensure that:

Recommendation 7: user access to the accounting information system is set up in accordance with the employee's responsibilities so that access to financial records is limited.

Recommendation 8: duties involving the maintenance of the vendor list and vendor payment processing are adequately segregated and the vendor list is regularly purged and maintained to reflect current active vendor information.

Recommendation 9: all expenses incurred by the grantee are reviewed and appropriately approved before a commitment of resources is made. This includes documenting and dating the review and approval on invoices or other source documents.

Recommendation 10: the accounting information system is configured to detect duplicate check numbers and generate warnings notifying the user of the anomaly. Furthermore, the ability to override these warnings should be disabled/restricted in the system and the user should be expected to comply with them. Abiding by the system's controls will enhance the integrity of the financial records.

CREDIT CARDS

SLSC's written policies and procedures over credit cards do not fully adhere to LSC's *Fundamental Criteria*. The OIG reviewed seven credit card statements consisting of 71 transactions from one credit card account, totaling $21,114. Review and testing of the grantee's practices over credit cards revealed additional controls that need strengthening.

Inadequate Written Policy

The OIG reviewed the credit card policies and procedures in SLSC's Accounting Policies and Procedures Manual and found them to be lacking details regarding payment procedures, approval process, types of allowable charges, how unallowable charges are handled, specific types of supporting documentation that should be provided, reconciliation processes and user acknowledgment forms required for authorized users.

The Finance Manager did not know the grantee's accounting manual required this level of detail.

The LSC Accounting Manual Section 3-4 states that each grantee must develop a written accounting manual that describes the specific procedures to be followed by the grantee in complying with the *Fundamental Criteria*.

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

Not in Accordance with Policies and Procedures

In discussions with the Finance Manager, the OIG found that unauthorized credit card users have the combination and access to the locked cabinet where the credit card is stored. SLSC's Accounting Policies and Procedures Manual dated August 2017 states that only the Executive Director is authorized to remove the credit card from the cabinet; however, the OIG also found that all authorized users have the combination and access to the locked cabinet.

The Finance Manager stated that the locked cabinet where the credit card is stored is the only safe the grantee has but will work with management to determine how the credit card could be adequately secured.

The OIG found that out of the 71 transactions reviewed, three transactions in the amount of $1,318 were made by two unauthorized credit card users. An additional three transactions in the amount of $1,861 were not documented in the grantee's credit card log and the initials of the person(s) responsible for the transactions were missing. Therefore, it is impossible to know if the transactions were made by an authorized credit card user.

SLSC's Accounting Policies and Procedures Manual states that any credit card purchase must be recorded in a credit card log, which includes the date purchased, vendor, amount, brief description of item(s) purchases, and initials of two different approved users.

The Finance Manager stated that two employees who are not authorized users received approval from the Executive Director for the transactions, however, she tries to disallow unauthorized use of the credit card under any circumstances. The Finance Manager also stated that recently the grantee has corrected the issue of the credit card log being completed, but realized that controls need to be strengthened.

There is an increased risk of unauthorized purchases when there is no limit to the number of debit/credit card users. Failure to follow the purchase approval process may result in purchases made without the knowledge of appropriate management or at unacceptable prices or terms. Without adequate internal verification, cash may be disbursed for goods and services not received, in advance of receipt, or in the wrong amount.

Missing Approvals

The OIG found that out of the 71 transactions reviewed, totaling $21,114, 23 transactions in the amount of $12,131 did not have the appropriate requisite approvals. Three of these transactions, totaling $6,005, did not have the prior approval of two authorized users as required by the grantee's policies and procedures for purchases greater than $1,000.

The Finance Manager realizes that they need to tighten this internal control and ensure all line items receive requisite approval.

The LSC Accounting Manual, Section 3-5.4, states that approval should be required at an appropriate level of management before a commitment of resources is made. SLSC's Accounting Policies and Procedures Manual dated August 2017 states that any credit card purchases more than $1,000 must have prior approval of two authorized users.

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

Recommendations: The Executive Director should:

Recommendation 11: update the Accounting Policies and Procedures Manual to include details regarding:

- the credit card payment procedures;
- the approval process;
- how impermissible charges are handled;
- the type of charges allowed;
- the types of supporting documentation required;
- the issuance processes; and
- the reconciliation processes.

Recommendation 12: obtain a written agreement for each current, authorized credit card user. For future authorized users, this should be a requirement. This document should stipulate that it is the holder's responsibility to use the card for business purposes only, and that no misuse will occur. It should state that the cardholder will be held accountable for any personal charges made on the card.

Recommendation 13: ensure the credit card is secured so only the Executive Director has access, as stated by the SLSC Accounting Policies and Procedures Manual.

Recommendation 14: ensure that only authorized users with signed credit card agreement forms on file use the credit card.

Recommendation 15: enforce the grantee's current policy and ensure that authorized users record any credit card purchases in the credit card log.

Recommendation 16: ensure approvals are made and documented in the credit card log for all credit card transactions, including the two signatures required for transactions over $1,000.

PAYROLL

SLSC's written policies and procedures for payroll are comparable to LSC's *Fundamental Criteria*. However, the OIG reviewed the grantee's payroll processes in place and found several inadequate internal control practices.

Payroll Account Not Being Used

The OIG interview with the Program Administrator found that the grantee's payroll process is outsourced through PayChex, a payroll servicing company. However, the payroll bank account has been dormant for years and payroll transactions have been processed through the grantee's general operating account.

The Finance Manager stated that she plans to work with the bank to have the payroll account work the way it was supposed to when it was set up. She indicated that SLSC should have been processing payroll through the payroll bank account.

LSC Accounting Guide, Appendix VII, stipulates that payroll activities, including electronic transactions processed, should have a designated payroll account that is separate from the general bank account.

While the grantee outsources payroll, a separate payroll account adds another layer of security to the grantee's banking system.

Timesheets Not Approved by the Supervisor

Ten employee records were randomly selected to review content and accuracy of the payroll register, including pay rates, timesheets, and attendance records. This test work revealed that the content of the payroll register is accurate and no discrepancies were found. However, it was determined that the paper-based timesheets are not reviewed and approved by the employees' immediate supervisor. Instead, the Program Administrator is tasked with review and approval of all employee timesheets.

The Program Administrator stated that she is responsible for the review and approval of all employee timesheets. This is because employees report their attendance directly to her which makes the monitoring all employee attendance records her responsibility.

LSC Accounting Guide, 3.5.5 Payroll, Attendance Record or Time Record stipulates that an attendance record or time record shall be maintained for each employee and shall be approved by the employee's supervisor.

If timesheets are approved by someone other than an employee's immediate supervisor, or someone without knowledge of the actual time worked by an employee, it may result in approval of incorrect attendance data. With paper-based timesheets it is easy for employees to enter incorrect times of work arrival and departure, or overstate or round hours worked up to the nearest hour. Overpayment may occur, as the employee is paid based on incorrect or potentially even falsified hours or rates. Therefore, employees may be paid for days or hours not worked.

Recommendations: The Executive Director should ensure that:

Recommendation 17: payroll activities are not processed in the general bank account but in a separate payroll account with staff properly adequately trained on the operation of the account.

Recommendation 18: timesheets are monitored and approved by the employee's immediate supervisor that has daily contact with staff.

INTERNAL REPORTING AND BUDGETING

SLSC's written policies over management reporting and budgeting appear to be reasonable and comparable with the *Fundamental Criteria* of LSC's Accounting Guide. As such, the Executive Director receive monthly reports and the budgeting process involves SLSC management. However, the budgets are not created according to cost or function and expenses per grant are not included in the management reports.

Budgets - Not According to Cost or Function

An OIG review of the grantee's budget reports and procedures found that the grantee prepares budgets at the beginning of the year based on historical data and/or totals.

The Finance Manager stated the grantee does not budget according to function or cost centers because of the grantee's small size.

LSC Accounting Guide, 3-5.11, stipulates that budget projections should be built from cost centers/functions.

Projections made centrally without adequate input from the cost center manager may result in incomplete information and a distortion of the projected financial condition of the recipient.

Management Reports - Expenses Not Tracked per Grant

The grantee does not track expenses per grant as part of the monthly management reports. The monthly reports reviewed by the Executive Director include income and expense, balance sheet and cash flow analysis reports. However, these monthly reports present only the overall totals from all funding sources and not the totals per funding source. There was no "Funding Source Budget vs. Actual" included in the monthly reports, which can be processed through the grantee's current accounting software.

The Finance Manager's understanding is that it is not an LSC requirement to track expenses per grant in monthly reports, the grantee is only required to submit financial reports once a year.

LSC Accounting Guide, 3-5.9, Management Reporting, Funding Source Budget vs. Actual, stipulates that special reports by funding source designed to meet grantor and internal reporting requirement should be prepared as required. In addition, 2-4.1, Financial Reporting, Overview, stipulates that accounting records must accommodate the accumulating and supporting of costs by grant and contract. As a best practice, an LSC grantee's accounting records maintained on a funds accounting basis provides an adequate basis upon which to prepare its annual financial statements.

The consolidated report lacks the detail necessary for proper analysis and control of cost center or program spending. Also, failure to comply with funding source requirements can result in a reduction or loss of funding.

Recommendations: The Executive Director should ensure that:

Recommendation 19: budgets are built from cost centers or funding sources.

Recommendation 20: expenses are tracked by grant within the accounting system so that a report for each funding source versus actual can be incorporated as a part of monthly management reports.

FIXED ASSETS

SLSC's written policies and procedures over fixed assets are mostly comparable to the LSC Accounting Guide, and the LSC Property Acquisition and Management Manual. The OIG examined documentation and inspected property in the grantee's office, and determined that acquisitions, disposals, and maintenance over fixed assets were mostly compliant with the LSC Accounting Guide, 45 CFR §1630.5, and the Property Acquisition and Management Manual. However, exceptions were noted in the property records, general journal entries, and procurement of IT equipment.

Written Policies

OIG's review of SLSC's written policies and procedures for fixed assets determined there were some polices that need to be updated to fully adhere to LSC's *Fundamental Criteria,* Including the following:

- personal property disposal policies do not state that prior approval is required from LSC when transferring an LSC-funded asset to another non-profit organization; and
- it is not specified if quotes are required for the sale of property with a fair market value exceeding $15,000.

We also noted that SLSC's Accounting Policies and Procedures Manual dated August 2017 included a policy stating that property may be transferred to its employees after other means have been exhausted. LSC's Property Acquisition and Management Manual (PAMM) Section 6.5(d) notes grantees shall not dispose of items of personal property by sale, donation or other transfer of the property to the grantees' board members and employees. (This prohibition is continued in 45 CFR Part 1631, the successor, to the PAMM, effective December 31, 2017).

The Finance Manager stated she updated the Accounting Policies and Procedures Manual on short notice and probably overlooked the LSC PAMM rules pertaining to the transfer of LSC personal property, required quotes for the sale of LSC personal property, and the restricted transfer of LSC personal property to the grantee's board members and employees.

The LSC Accounting Guide, Section 3-4.5, stipulates 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*.

Without detailed written policies and procedures, there could be a lack of transparency and consistency in the application of proper accounting for fixed assets, especially in cases of staff turnover. Furthermore, the grantee may incur losses due to misplaced or improper disposal of property.

Lack of Review/Approval of Journal Entries

General journal entries and documentation for the 2016 physical inventory were not reviewed/approved by the Finance Manager as prescribed by the grantee's written policies and procedures. The Bookkeeper performed the annual physical inventory and prepared the adjusting journal entries with no independent review. Therefore, there was no segregation of duties in the performance and approval of the 2016 physical inventory process nor regarding the resulting year-end adjusting general journal entries for acquisitions, disposals, and depreciation in 2016. Review/approval was also lacking in the 2017 journal entries for the acquisition of the new telephone system and disposal of the old telephone system.

The Bookkeeper stated the most recent physical inventory, performed in January 2017, was not reviewed/approved by the Finance Manager because it was the first inventory done since the Finance Manager began employment at SLSC. As a result, the Bookkeeper overlooked submitting the entries for the Finance Manager's review/approval as was required by the new internal processes. She explained she is still becoming acclimated to the new work-flow processes where the Finance Manager is involved.

According to the LSC Accounting Guide, Section 3.5-6, each entry to the general journal should be approved by an authorized individual. Furthermore, Appendix VII C.5 states that adjustments to fixed-asset records and general ledger control accounts should be reviewed and approved by an appropriate organization employee or officer who does not have the responsibility for maintaining fixed-asset records. Per SLSC's Accounting Policies and Procedures Manual dated August 2017, the Finance Manager is responsible for approving general journal entries prepared by the Bookkeeper.

Unsupported or poorly referenced entries are difficult to trace and make it difficult to detect irregularities. In addition, a failure to identify proper roles and responsibilities may result in transactions, adjustments and journal entries that are not in accordance with management criteria, not processed, processed late or processed in a careless manner.

Incomplete Fixed Assets Records

Based on test work performed, the LSC OIG determined that SLSC's Fixed Asset inventory records do not include the check number used to pay for an item, funding source and the disposition data. During the review of the grantee's Accounting Policies and Procedures Manual dated August 2017 regarding fixed assets, the elements listed for property records were missing the same attributes.

The Bookkeeper acknowledged that the information is not included in the Fixed Asset Inventory spreadsheet; she maintains an inventory folder where she keeps copies of some checks but not all. She also explained most capital acquisitions are procured with LSC funds because LSC is SLSC's major funder. The grantee's smaller funders do not allow capital expenditures. The Finance Manager stated the grantee was not aware of all the elements required by the *Fundamental Criteria*, but would update accordingly.

The LSC Accounting Guide, Appendix II, Description of Accounting Records, stipulates that the property record, at a minimum, should include the following: description, date of acquisition, check number used to pay for the item(s), cost of the property and salvage value, useful life, depreciation method, source of funds used to acquire property, description of value assigned to donated property, location of property, inventory control tag number, and the ultimate disposition date.

Failure to maintain adequate property records may result in the inability to fully account for fixed assets purchases and to support property asset balances and their depreciation amounts.

Recommendations: The Executive Director should:

Recommendation 21: update the Accounting Policies and Procedures Manual dated August 2017 to reflect the property records' required elements.

Recommendation 22: ensure management performs and documents the review and approval of general journal entries for the physical inventory, acquisitions, disposals, and depreciation of property and that the preparer and approver are different authorized individuals.

Recommendation 23: ensure the grantee's property records are updated to include the check number used to pay for the item, source of funds used to acquire the property, and the ultimate disposition data to comply with the minimum requirements mandated by LSC.

GENERAL LEDGER AND FINANCIAL CONTROLS

SLSC's written policies and procedures for general ledger and financial controls are not fully comparable to LSC's *Fundamental Criteria*. Also, while performing test work, the OIG found some inadequate practices in place.

Written Policy Needs to be Updated

The grantee's written policies and procedures regarding general ledger and financial controls lacked information detailing how outstanding/ stale checks are handled and how the accounting system provides for separation of receipts and disbursements of LSC and non-LSC funds in accordance with 45 CFR §1610.9.

The Finance Manager did not know that the grantee's accounting manual required this level of detail.

The LSC Accounting Guide, Section 3-4, states that each grantee must develop a written accounting manual that describes the specific procedures to be followed by the grantee in complying with the *Fundamental Criteria*.

Written policies and procedures serve as a method to document the design of controls and adequately communicate them to the staff. Without detailed written procedures over general ledger and financial controls, there could be a lack of transparency and consistency in the distribution of the benefits.

Petty Cash Not Being Reconciled Periodically

Based on the test work performed, the maintenance of the petty cash is lacking adequate internal controls. The grantee maintains a petty cash fund of $100, however the petty cash is not being reconciled on a consistent and periodic basis. There is also no documented evidence of when the petty cash is being reconciled and if the reconciliations are approved by the Finance Manager or the Executive Director.

The Finance Manager stated that she recently asked the Bookkeeper to start reconciling the petty cash on a more consistent basis, and that the grantee will have to create a log to document the dates, review, and approval of the reconciliations. The Bookkeeper stated that she has been trying to make it a habit to reconcile the petty cash on a regular basis instead of sporadically.

The LSC Accounting Guide, section 3-5.4(d), stipulates that reconciliations shall be reviewed and approved by a responsible individual and that such review shall be appropriately documented by signature and date.

The reconciliation procedure is a fundamental control technique and its use is critical, especially in an environment where full segregation of duties is not practicable. Proper reconciliation procedures will substantially increase the likelihood of irregular disbursements and recording errors being discovered on a timely basis. Without management review and control the petty cash account is readily subject to misuse.

Recommendations: The Executive Director should ensure:

Recommendation 24: the Accounting Policies and Procedures Manual is updated to include details on the handling of outstanding checks and how the accounting system provides for separation of receipts and disbursements of LSC and non-LSC funds in accordance with 45 CFR §1610.9.

Recommendation 25: that the petty cash account is periodically reconciled, then reviewed and approved by someone other than the person performing the reconciliation.

GRANTEE MANAGEMENT COMMENTS

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

- They will ensure that all expenses are allocated to funding sources based on predetermined formulas outlined in the cost accounting policy.
- The Finance Manager and Bookkeeper were trained on the accounting system to understand the program.
- They have assigned staff to keep a centralized filing system for all contracts and pertinent supporting documentation, to ensure all contracts meet requirements, and are attempting to obtain contacts from vendors for which they have recurring transactions.
- They are working with the IT Administrator to change the current settings for user access to the accounting software system.
- Annually, upon completion of the audit, the Finance Manager will review the current vendor list and will make "inactive" any vendors that had no transactions during the year.
- The Finance Manager will review and approve all invoices before payment is made, documenting and dating review of invoices or other source documents.
- The accounting system has warnings notifying the user of duplicate check numbers.
- The Accounting Policies and Procedures Manual will be updated to revise the credit card purchase process, reflect LSC's requirements for fixed assets, include the process for handling outstanding checks, and to incorporate all the elements outlined in 45 CFR §1610.9
- The Finance Manager will take responsibility for ensuring that all authorized credit card users have a signed written agreement, only authorized users use the credit cards, and policies are adhered to going forward.
- The grantee will have multiple credit cards in the names of the authorized users for credit card purchases, thereby making each user responsible for the security of his/her card.
- The existing payroll bank account was fixed and will be used to run through payroll transactions.
- Timesheets will be monitored and approved by employee's immediate supervisor.
- Future budgets will be built on funding source requirements and supporting documentation will be maintained.
- General journal entries for the physical inventory will be prepared by the Bookkeeper and reviewed and approved by the Finance Manager.
- Property records have been updated to include all required elements.
- The Bookkeeper reconciles petty cash monthly with review by the Finance Manager, and a log has been set up to show the reconciliation and approval process.

OIG EVALUATION OF GRANTEE MANAGEMENT COMMENTS

The OIG considers the proposed actions to all the Recommendations as responsive. The actions planned and implemented by grantee management to address the issues and revise and updates its Accounting Policies and Procedures Manual should correct the issues identified in the report.

Recommendations 1 and 2 will remain open until we receive supporting documentation of an expense report by funding source generated from QuickBooks.

Recommendation 7 will remain open until the grantee provides supporting documentation of the updated user access rights for the accounting system.

Recommendation 8 will remain open until the grantee updates the vendor list and purges vendors no longer used.

Recommendations 11, 21, and 24 will remain open until we receive the updated Accounting Policies and Procedures Manual.

Recommendations 12 and 13 will remain open until the grantee provides supporting documentation of the updated list of authorized users and their credit card acknowledgement receipts.

Recommendation 17 will remain open until the grantee provides supporting documentation of a payroll bank account statement where the account was used to process payroll.

Recommendation 18 will remain open until supporting documentation is provided of timesheets being approved by immediate supervisors.

Recommendations 19 and 20 will remain open until we receive supporting documentation of the accounting system generating monthly management reports of expenses and budget versus actuals by funding source.

Recommendation 23 will remain open until the grantee provides supporting documentation of the updated property records including all required elements.

Recommendations 3, 4, 5, 6, 9, 10, 14, 15, 16, 22, and 25 are considered closed.

APPENDIX I

SCOPE AND METHODOLOGY

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

- Cash Disbursements,
- Credit/debit cards,
- Contracting,
- Cost Allocation,
- Derivative income,
- General Ledger and Financial Controls,
- Internal Management Reporting and Budgeting,
- Property and Equipment,
- Employee Benefits and
- Payroll.

To obtain an understanding of the internal controls over areas reviewed, grantee policies and procedures were reviewed including manuals, guidelines, memoranda and directives, setting forth current grantee practices. Grantee officials were interviewed to obtain an understanding of the internal control framework and management and staff were interviewed as to their knowledge and understanding of the processes in place. To review and evaluate internal controls, the grantee's internal control system and processes were compared to the guidelines in the *Fundamental Criteria of an Accounting and Financial Reporting System (Fundamental Criteria)* contained in the LSC Accounting Guide. This review was limited in scope and not sufficient for expressing an opinion on the entire system of grantee internal controls over financial operations.

We assessed the reliability of computer generated data the grantee provided by reviewing available supporting documentation for the entries selected for review, conducting interviews and making physical observations to determine data consistency and reasonableness. We performed various tasks to determine reliability of data used during our fieldwork including vouching, recalculations, tracing, and comparing data. Based on steps performed, we determined that the computer processed data is reliable and sufficient 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 84 disbursements which included 110 transactions totaling $262,842.37. The sample represented approximately 22 percent of the $1,185,464.56 disbursed for expenses other than payroll during the period July 1, 2016 through August 31, 2017. To assess the appropriateness of expenditures, we reviewed invoices and vendor lists, 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 sampled seven credit card statements consisting of 71 transactions totaling $21,114.03. We assessed the appropriateness of the expenditures and 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, we interviewed appropriate program personnel, examined related policies and procedures as applicable and selected specific transactions to review for adequacy.

To evaluate the adequacy of the cost allocation process, we discussed the process with grantee management and requested, for review, the grantee's written cost allocation policies and procedures as required by the LSC Accounting Guide. We reviewed selected transactions to determine if the amounts allocated were in conformity with the documented SLSC allocation process and if the transactions were properly allocated in the accounting system.

Controls over purchasing, recording, inventorying and disposing of property and equipment were reviewed by examining current grantee practices in comparison with LSC regulations and policies outlined in the LSC Accounting Guide.

The on-site fieldwork was conducted from October 16, 2017 through October 25, 2017. Our work was conducted at the grantee's administrative office in Wethersfield, CT and at LSC headquarters in Washington, DC. Documents reviewed pertained to the period July 1, 2016 through August 31, 2017.

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

APPENDIX II

STATEWIDE LEGAL SERVICES OF CONNECTICUT, INC.
RNO 107000

RESPONSES TO
<u>LCS-OIG REPORT ON SELECTED INTERNAL CONTROLS</u>

Cost Allocation:

<u>Recommendation 1</u>: Ensure the accounting system's general ledger is designed to accommodate fund, cost or functional accounting which would allow for allocation of expenses by funding source and provide an adequate audit trail.

We have checked the version of Quickbooks we are using and it can accommodate fund accounting. By April 30, 2018, the Finance Manager and Bookkeeper will ensure that all expenses for calendar year 2018 and subsequent years are allocated to funding sources based on predetermined formulas outlined in our *Cost Accounting Policy*, which is part of our *Accounting Policies and Procedures Manual*.

<u>Recommendation 2</u>: Enforce consistency in following the written cost allocation policy including all formulas and methodology.

As mentioned above, the Finance Manager and Bookkeeper will ensure that all SLS expenses will be allocated to funding sources based on the methodology outlined in our *Cost Accounting Policy*.

<u>Recommendation 3</u>: Ensure the accounting staff will obtain training on the accounting system's capabilities so staff will be able to utilize all the functions contained within the system.

In August 2017, the Finance Manager and Bookkeeper participated in a 3-day webinar on the functions of Quickbooks for Nonprofits, the version of Quickbooks we are currently using. We also purchased the manuals that were offered with the webinar series, which will further help us to understand the program. And lastly, we have just been contacted by a Business Advisor from Quickbooks who will be available to us now if we need help meeting our needs.

Contracting:

<u>Recommendation 4</u>: Contracts for services are written, signed, and maintained for all business arrangements, especially those recurring in nature. The contract should fully document the agreed upon terms, selling price, and payment terms and should be reviewed periodically to ensure that written terms are defined and current.

The Finance Manager has assumed responsibility for ensuring that all contracts going forward meet the above requirements. She is also attempting to obtain contracts from vendors to which SLS has had recurring transactions in the past, but no formal contracts are currently on file.

Recommendation 5: 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, required approvals, and any agreed upon modifications to a contract or agreement.

The Finance Manager has taken responsibility for keeping a centralized filing system for all contracts and ensuring that all pertinent documents are kept in this file.

Recommendation 6: The process for each contract action is fully documented in writing, such as sole source justification and documentation of competition, if competitively bid.

The Finance Manager will ensure that all contracts entered into by SLS will be fully documented and follow the requirements outlined by LSC. She will also document sole source justification for those contracts previously entered into by SLS management prior to her hire date and which are still active.

Disbursements:

Recommendation 7: User access to the accounting information system is set up in accordance with the employee's responsibilities so that access to the financial records is limited.

By March 15, 2018, the Finance Manager will work with SLS' IT Administrator to change the current settings for user access to the accounting software system. The Finance Manager will have full user access to the accounting system, whereas the Bookkeeper will have limited access pursuant to her job responsibilities. The Finance Manager will also update the *Accounting Policies and Procedures Manual* to include the User access policy for the accounting system. Revisions to the manual are expected to be completed by April 30, 2018.

Recommendation 8: Duties involving the maintenance of the vendor list and vendor payment processing are adequately segregated and the vendor list is regularly purged and maintained to reflect current active vendor information.

The Finance Manager will take responsibility for maintaining the vendor list, adding new vendors when needed. Annually, upon completion of the audit, the Finance Manager will review the current vendor list and will make "inactive" any vendors that have had no transactions during the year. The vendor payment process has already been segregated between the Finance Manager and the Bookkeeper. Specific duties related to this process will be outlined in the revised *Accounting Policies and Procedures Manual*.

Recommendation 9: All expenses incurred by the grantee are reviewed and appropriately approved before a commitment of resources is made. This includes documenting and dating said review and approval on invoices and other source documents.

The Finance Manager has taken responsibility for this process. She reviews and approves all invoices before payment is made. Documenting and dating review of invoices or other source documents has already been put into place as of October 1, 2017.

Recommendation 10: The accounting information system is configured to detect duplicate check numbers and generate warnings notifying the user of the anomaly. Furthermore, the ability to override these warnings should be disabled/restricted in the system and the user should be expected to comply with them. Abiding by the system's controls will enhance the integrity of the financial records.

The Finance Manager and Bookkeeper have ensured that the accounting system does have warnings notifying the user of duplicate check numbers. This warning system has not been disabled.

Credit Cards:

Recommendation 11: Update the Accounting Policies and Procedures Manual to include details regarding:

- the credit card payment procedures;
- the approval process;
- how impermissible charges are handled;
- the type of charges allowed;
- the types of supporting documentation required;
- the issuance processes; and,
- the reconciliation processes.

The Finance Manager will be revising the section on *Credit Card Purchases* in the *Accounting Policies and Procedures Manual* to reflect the new procedures in place and will ensure that all of the above requirements are included in this section. She anticipates making final changes to the credit card purchases policy by March 1, 2018 and will include these changes in the revised manual expected to be completed by April 30, 2018, with subsequent approval by the Finance & Audit Committee at their May 2018 meeting.

Recommendation 12: Obtain a written agreement for each current, authorized credit card user. For further authorized users, this should be a requirement. This document should stipulate that it is the holder's responsibility to use the card for business purposes only, and that no misuse will occur. It should state that the cardholder will be held accountable for any personal charges made on the card.

The Finance Manager will take responsibility for ensuring that all authorized credit card users will have a signed written agreement in place by March 1, 2018.

Recommendation 13: Ensure the credit card is secured so only the Executive Director has access, as stated by the SLSC Accounting Policies and Procedures Manual.

As stated above, new procedures will be in place regarding credit card purchases. It has been decided that instead of just one credit card for the Executive Director, we will have multiple credit cards in the names of the authorized users for credit card purchases. Each user will be responsible for the security of his/her card. We expect to have the cards in place by March 30, 2018. Each user will sign a written agreement outlining their responsibilities regarding credit card use and security of their card. All procedures regarding the use of the card will be outlined in SLS' accounting manual.

Recommendation 14: Ensure that only authorized users with signed credit card agreement forms on file use the credit card.

The Finance Manager will be responsible for ensuring that only authorized users are allowed to use the credit card. She will take responsibility of the credit card and credit card log and ensure that all signatures, documentation, etc. has been obtained for accounting purposes.

Recommendation 15: Enforce the grantee's current policy and ensure that authorized users record any credit card purchases in the credit card log.

The Finance Manager will ensure that the revised credit card purchases policy as outlined in the revised *Accounting Policies and Procedures Manual* is adhered to going forward.

Recommendation 16: Ensure approvals are made and documented in the credit card log for all credit card transaction, including the two signatures required for transactions over $1,000.

The Finance Manager will ensure that the revised credit card purchases policy as outlined in the revised *Accounting Policies and Procedures Manual* is adhered to going forward.

Payroll:

Recommendation 17: Payroll activities are not processed in the general bank account but in a separate payroll account with staff properly and adequately trained on the operation of the account.

As of the second payroll in March 2018, all payroll transactions will run through a separate payroll account. The Finance Manager has worked with Webster Bank to fix the existing SLS payroll bank account to work as it should to accommodate the process.

Recommendation 18: Timesheets are monitored and approved by the employee's immediate supervisor that has daily contact with staff.

This process will be implemented as of March 1, 2018.

Internal Reporting and Budgeting:

Recommendation 19: Budgets are built from cost centers or funding sources.

The Finance Manager will take responsibility to ensure that future SLS budgets are built on funding source requirements and will ensure that documentation on the process is maintained.

Recommendation 20: Expenses are tracked by grant within the accounting system so that a report for each funding source versus actual can be incorporated as a part of the monthly management reports.

We expect to have this process in place by April 30, 2018.

Fixed Assets:

Recommendation 21: Update the Accounting Policies and Procedures Manual dated August 2017 to reflect the property records' required elements.

The Finance Manager will take responsibility for updating the accounting manual to reflect LSC's requirements for fixed assets. She expects to have all revisions to the *Accounting Policies and Procedures Manual* made by April 30, 2018.

Recommendation 22: Ensure management performs and documents the review and approval of general journal entries for the physical inventory, acquisitions, disposals, and depreciation of property and that the preparer and approver are different authorized individuals.

The Bookkeeper will make the general journal entries for the physical inventory and the Finance Manager will review and approve them. This has been done and documented for the 2017 inventory records.

Recommendation 23: Ensure the grantee's property records are updated to include the check number used to pay for the item, source of funds used to acquire the property, and the ultimate disposition data to comply with the minimum requirements mandated by LSC.

The Finance Manager has taken responsibility for ensuring that SLS' property records for 2017 have been updated to include the items mentioned above. She will continue to monitor the process going forward to ensure that all elements required by LSC are included in the property records.

General Ledger and Financial Controls:

Recommendation 24: The Accounting Policies and Procedures Manual is updated to include details on the handling of outstanding checks and how the accounting system provides for separation of receipts and disbursements of LSC and non-LSC funds in accordance with 45 CFR §1610.9.

The Finance Manager will take responsibility for ensuring that the accounting manual is updated to include the process for handling outstanding checks and ensuring it incorporates all of the elements outlined in 45 CFR §1610.9. She expects to have the revised accounting manual completed by April 30, 2018.

Recommendation 25: Ensure that the petty cash account is periodically reconciled, then reviewed and approved by someone other than the person performing the reconciliation.

This process has already been put into place. The Bookkeeper is reconciling petty cash on a monthly basis now, with review by the Finance Manager. A log has been set up to show the reconciliation and approval of the petty cash account.