Office of Inspector General
Legal Services Corporation

Inspector General
Jeffrey E. Schanz

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June 16, 2016

Mr. Harrison Mciver
Executive Director
Memphis Area Legal Services, Inc.
Falls Building
22 N. Front Street, 11th Floor
Memphis, TN 38103-5013

Dear Mr. Mciver:

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

The OIG considers your proposed actions to address Recommendations 1 through 6 as responsive. The actions planned by grantee management to address the issues and revise and update its Accounting Manual should correct the issues identified in the report.

However, Recommendations 1, 2, 4 and 6 will remain open until the grantee has drafted the respective policies, revised its Accounting Manual and obtained the required Board of Directors' approval. Recommendation 5 will remain open until the grantee has provided the OIG documentation showing that the contracts for operating leases have been reopened and put out for bid.

The OIG accepts the stated actions for recommendation 3 related to the completion and approval of supply request forms and it is considered closed.

Please provide us with your response to close out the remaining five open recommendations along with the revised Accounting Manual within six months of the date of this final report.

Sincerely,

Jeffrey E. Schanz
Inspector General

Enclosure

cc: Legal Services Corporation
Jim Sandman, President

Lynn Jennings, Vice President
For Grants Management

Memphis Area Legal Services, Inc.
Justin M. Ross
Board Chairperson

Sent by E-mail to Board of Directors
Sean A. Hunt
Rose Benson
Clayton C. Prudom
Annie T. Christoff
Michael J. Fletcher
Thad S. Rodda, Jr.
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LEGAL SERVICES CORPORATION

OFFICE OF INSPECTOR GENERAL

FINAL REPORT ON SELECTED INTERNAL CONTROLS

MEMPHIS AREA LEGAL SERVICES

RNO 643030

Report No. AU 16-06

June 2016

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 Memphis Area Legal Services (MALS or grantee) related to specific grantee operations and oversight. Audit work was conducted at the grantee's administrative office in Memphis, TN and at LSC headquarters in Washington, DC.

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

> [T]he process put in place, managed and maintained by the recipients' 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

Memphis Area Legal Services (MALS) is a non-profit Tennessee organization that provides free legal assistance in civil matters to persons in Fayette, Lauderdale, Shelby and Tipton counties. MALS is the primary provider of civil legal representation to low income families in the areas of domestic violence, mortgage foreclosures, wrongful denial of healthcare, consumer fraud, and special challenges of children and the elderly. MALS operates out of its Memphis and Covington, TN offices.

MALS receives grants and contributions from a variety of sources including governmental agencies and private contributions. According to audited financial statements for the year ended December 31, 2014, the grantee received a total of $3,455,860 in LSC and non-LSC funding. Approximately 40 percent of the grantee's total support funding was provided by LSC in the amount of $1,392,197. Approximately, 60 percent was non-LSC funding in the amount of $2,063,663.

OBJECTIVE

The overall objective was to assess the adequacy of selected internal controls in place at the grantee as the controls related to specific grantee operations and oversight, including program expenditures and fiscal accountability. Specifically, the audit evaluated selected financial and administrative areas and tested the related controls to ensure that costs were adequately supported and allowed under the LSC Act and LSC regulations.

AUDIT FINDINGS

To accomplish the audit objective, the OIG reviewed and tested internal controls related to cash disbursements, credit cards, cost allocation, contracting, fixed assets, general ledger controls, derivative income, internal reporting and budgeting, and employee benefits and payroll. While many of the controls were adequately designed and properly implemented as they relate to the specific grantee operations and oversight, some controls need to be strengthened and formalized in writing. The OIG identified the following areas that need improvement.

WRITTEN POLICIES AND PROCEDURES

Overall, the grantee's written policies and procedures in the areas of cash disbursements, credit cards, contracting, fixed assets, derivative income, budgeting and employee benefits need strengthening to properly describe the controls and procedures followed by the grantee. Section 3-4 of the Accounting Guide states that each grantee must develop a written accounting manual that describes the specific procedures to be followed in order to comply with LSC's *Fundamental Criteria of an Accounting and Financial Reporting System (Fundamental Criteria)*. For the most part, the grantee had adequate practices in place; however, the level of detail must be enhanced in the Accounting Manual and Employee Handbook.

Master Vendor List Policy

The grantee has no policies and procedures in place over the maintenance of the master vendor list. A policy in this area should address processes on establishing new vendors, changing and editing information, and deactivating or deleting vendors in the system. Currently, the Financial Administrator, responsible for initiating and processing payments, is also responsible for creating new vendors and editing vendor information without the review and approval of management. A lack of controls over the maintenance of the master vendor list increases the potential for creating unauthorized vendors, which may result in fraud.

Credit Card Policy

MALS maintains written policies on credit card usage. However, the policies need to be strengthened to include procedures relating to the activation and cancellation of credit cards of terminated employees or employees who are no longer authorized to use grantee credit cards. The policies also do not include a set maximum dollar limit. The grantee uses a credit card receipt voucher form to accumulate and record loose receipts for tracking purposes. However, controls over this form and its purpose are not included in the grantee's Accounting Manual.

Section 3-4 of the Accounting Guide and Chapter 3-6 (Fraud Prevention Guide), stipulates that recipients should set credit card spending limits for its users. Without adequate policies and procedures over the issuance and use of credit cards, transactions may be initiated that violate management intentions and resources may be wasted or used for unauthorized purposes.

Contracting Policy

The grantee has written policies and procedures for contracting that comply with the components of LSC's *Fundamental Criteria*; however, they do not address sole source procurements. Sole source business agreements are made without competition and should require supporting documentation such as a clear written justification on why the procurements were made without competition. Section 3-5.16 of LSC's Accounting Guide states that since not all contracts are the same, management should identify the contracting procedures for the various types of contracts. LSC's *Fundamental Criteria* also states that certain contracts should receive additional oversight. These include consulting, personal services and sole-source. Without policies and procedures over all types of contracts, the contracting process may be subject to fraud and/or abuse.

Fixed Assets Policy

The OIG reviewed the grantee's policies and procedures over fixed assets and found that there are adequate practices in place which are followed by grantee staff. However, for those practices related to capitalization, depreciation, and inventory, the written policy included in the Accounting Manual omits the following:

(1) the grantee's self-imposed $1,000 capitalization limit;
(2) procedures for reconciling the annual results of the physical inventory to the accounting records; and
(3) procedures on the disposal of obsolete property.

Creating and maintaining fixed asset policies and procedures can facilitate effective management of the grantee's fixed assets.

Derivative Income Policy

The grantee has no written policy on derivative income. The derivative income policy should include rent or that portion of any reimbursement or recovery of direct payments to attorneys, proceeds from the sale of assets, interest income, or other compensation or income attributable to any Corporation grant. Currently, the only derivative income the grantee has is interest income and attorney fees. Although the amount of interest income is minimal, the grantee should have a written policy in the Accounting Manual explaining the grantee's procedures with respect to the allocation of interest in this area. However, our testing and discussions with MALS management revealed that all interest income earned has traditionally been allocated to LSC.

Written policies and procedures over derivative income allows for proper recording to ensure that all funding sources are apportioned their fair share of income.

Budgeting Policy

The grantee's Accounting Manual does not contain adequate written policies and procedures on budgeting. Although the grantee has adequate practices in place, which are in accordance with LSC's *Fundamental Criteria*, the written policies need strengthening.

The policies are missing the following elements:

(1) Who is involved in creating the annual budget and when that process begins?
(2) What is the actual budget process; how are budgets formulated?
(3) Who reviews and approves the annual budget?
(4) The budget adjustment process;
(5) Timelines for budget completion and submission; and
(6) Documentation of budget assumptions.

Without detailed written policies and procedures there could be lack of transparency and consistency in the application of the budget process, especially in cases of staff turnover.

Employee Benefits Policy

As a result of our review of the grantee's Employee Handbook and interviews with staff, there are two monetary employee benefits offered that are not included in the Employee Handbook. The two benefits are (1) Loan Repayment Assistance Program (LRAP) and (2) Cell Phone Data Reimbursement. The LRAP is offered only to employees, and the cell phone data reimbursement is only offered to the executive staff. The LRAP allows for a $300 monthly reimbursement to employees with a limit of $3,600 in a year. At the time of the audit, nine people participated in the grantee's LRAP. We tested the documentation for six of the nine individuals and found those tested to be operating in accordance with grantee policy. Only the Executive Director and the Deputy Director currently receive the cell phone data reimbursement benefit. The grantee monitors their usage through the review of monthly invoices.

Employees are informed about all benefits at orientation, except the cell phone reimbursement, however, without all the benefits included in the Employee Handbook, employees may forget what is offered or not be made aware of updates relating to their official beneftis..

Recommendation 1: The Executive Director should either establish or update written policies for the:

a. master vendor list,
b. credit cards,
c. contracting,
d. fixed assets,
e. derivative income,
f. budgeting and
g. employee benefits.

The policies should adequately describe the process and controls currently in place at the grantee in sufficient detail and in accordance with LSC's Accounting Guide and *Fundamental Criteria.*

SEGREGATION OF DUTIES

Purchasing and Receiving

The LSC OIG found there was inadequate segregation of duties over the accounts payable, purchasing and receiving functions. The Financial Administrator whose duties include purchasing and receiving of supplies and other goods delivered at the grantee's Administrative Office is also responsible for the accounts payable process.

According to the Chief Financial Officer (CFO,) the receptionist serves as the receiving agent. The receptionist notifies the Financial Administrator when the goods are dropped off at the front desk.

Section 3-4 of the Accounting Guide, Internal Control Structure, Segregation of Duties, provides that accounting duties should be segregated to ensure that no individual has both physical control and record-keeping responsibility for any asset.

Not having adequate segregation of duties or proper compensating controls could result in misappropriation of grantee assets.

Recommendation 2*:* The Executive Director should ensure that a person independent of the purchasing and accounts payable functions receive and review goods for their condition and completeness when they arrive.

DISBURSEMENTS - SUPPLY REQUEST FORMS

The OIG reviewed 76 disbursements totaling $137,212.94 and 14 credit card statements with 137 transactions totaling $24,817.11. As a result, OIG found 7 disbursements and 20 credit card transactions where "Supply Request Forms" were not used correctly because the forms were either incomplete, approved after the fact or were not used at all. These forms are used to initiate and provide preapproval in the purchasing of supplies for MALS.

No Supply Request Form

- Five disbursements totalling $5,862.29 and three credit card transactions totalling $322.62 did not include a supply request form.

Supply Request Forms Approval Not Dated

- Eleven credit card transactions totalling $1,276.56 had supply request forms approved by the grantee's management, however, the approvals were not dated. Therefore, the OIG is unable to determine if the approvals were made prior to purchase.

Supply Request Forms Dated After Purchase

- Six credit card transactions totalling $1,468.72 had supply request forms that were approved after the purchases were made.

Section 3-5.4 of the Accounting Guide, Cash Disbursements, states that approval should be required at an appropriate level of management before making a commitment of resources. In addition, the MALS Accounting Manual states that supplies must be requested through the support staff via a supply request form that has been reviewed and approved by the Manager and CFO/Human Resources Officer.

The CFO acknowledged noncompliance with their policy as approvals are required prior to any purchase and that the supply request forms were not dated due to an oversight. The CFO also stated that management has not required the Covington Office to submit a supply request form because the Office Manager at that location knows what is needed and when it's needed. Inadequate documentation and pre-approval of disbursements can result in unauthorized purchases.

Recommendation 3*:* The Executive Director should ensure that Supply Request forms are properly completed and approved prior to disbursements and credit card purchases.

CONTRACTING

Lack of Supporting Documentation

There were a total of three contracts out of our sample of seven that had inadequate documentation supporting the related contract actions. Grantee management told us that two of the three contracts were competitively bid, however they did not have the bids on file. Also, the grantee could not locate two of seven contract agreements in our sample. The CFO stated that these contracts were very old, the actual bids could not be located and the contracts have never been opened for re-bid. There was also one sole sourced contract that did not have a sole source justification documented in the file. Overall, the OIG found that all seven contracts were properly approved and deliverables were received.

Below is a table summary of the seven contracts sampled:

Contracts	Total Amount Disbursed from 1/1/2015 to 12/31/2015	Type of Contract	Missing Documentation
Janitorial Services	$3,096.00	Competitive Bid	None
IT Consultant	$20,692.34	Competitive Bid	None
Copier Lease	$21,888.00	Competitive Bid	Bids
Kemps Case management service and maintenance	$16,679.00	Competitive Bid	Contract and Bids
Consultant for Database	$1,000.00	Competitive Bid	Contract
Consultant for Board Retreat - Sole Sourced	$1,225.00	Sole Sourced	Sole source justification
IPA	$21,500.00	Competitive Bid	None

Section 3-5.16 of the Accounting Guide, Contracting, states that the process used for each contract action should be fully documented and the documentation should be maintained in a central file. In addition, documents to support the competition should be retained in the contract file and any deviation from the approved contracting process should be fully documented, approved and also maintained in the contract file. As stated above, according to the CFO, the documentation of bids and contracts could not be located because these contracts had been established some time ago. Some of the contracts were up to 15 years old. In addition, the CFO explained there was no contract for the database project. Finally, due to an oversight, there was no sole source justification documented for the board retreat consultant who has had an established relationship with the Board members.

Contracting is a high-risk area with potential for abuse. In addition, since not all contracts are the same, for large contracts, competition helps ensure the best value for the grantee and proper documentation helps ensure that an approved contract has followed all established procedures.

Recommendations: The Executive Director should:

Recommendation 4: ensure that the process for each contract action is fully documented such as sole source justification and documentation of competition, if competitively bid. Documents should also be maintained in the central file.

Recommendation 5: consider re-opening contracts to the public for bidding to ensure that the grantee is receiving the best price and service available.

COST ALLOCATION

Untimely and Infrequent Allocation of Indirect Costs to Grants

Although the cost allocation formula is documented in writing and the methodology is fair, the frequency of allocation of common costs is not performed consistently. Specifically, the grantee has not performed allocation of administrative salaries as of the date of this audit, while other common cost allocations were performed at year end.

During our test work we found that the grantee uses a fund accounting system, Abila. Abila is set up with fund, account, grant and department codes so that a particular grant award, project, services or other activities of the grantee can be specifically identified. We also found that common costs were reasonably allocated among funding sources.

Section 3-5.9 of LSC's *Fundamental Criteria* states that common expenses shall be allocated among the sources on the basis agreed to by the applicable funding organizations, and in the absence of approved methods the allocation should be fair, consistent, and in an equitable manner to the individual cost centers and funds.

Grantee management explained that they would like to perform allocations on a quarterly basis. However, the grantee is not able to do so because of the lack of staffing and the high volume of assigned tasks and responsibilities. The untimely allocation of common cost and administrative salaries may result in improper cost distribution to funding sources and a distortion of financial reporting information.

Recommendation 6: The Executive Director should update the written cost allocation policy to include a timeline for completion of all allocations within the accounting period.

SUMMARY OF GRANTEE MANAGEMENT COMMENTS

Grantee management agreed with all findings in the report and accepted all six recommendations. Grantee management's formal comments can be found in Appendix II.

OIG EVALUATION OF GRANTEE MANGEMENT COMMENTS

The OIG considers the proposed actions to address Recommendations 1, 2, 3, 4, 5, 6, as responsive. The actions planned by grantee management to address the issues and revise and update its Accounting Manual should correct the issues identified in the report.

However, Recommendations 1, 2, 4 and 6 will remain open until the grantee has drafted the respective policies, revised its Accounting Manual and obtained the required Board of Directors' approval. Recommendation 5 will remain open until the grantee has provided the OIG documentation showing that the contracts for operating leases have been reopened and put out for bid.

Recommendation 3 related to the completion and approval of supply request forms is considered closed.

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 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 the 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 was 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 determined the data were sufficiently reliable for the purposes of this report.

To test for the appropriateness of expenditures and the existence of adequate supporting documentation, disbursements from a judgmentally selected sample of employee and vendor files were reviewed. The sample consisted of 90 disbursements and credit card transactions totaling $162,030.05. The sample represented approximately 14 percent of the $1,130,928 disbursed for expenses other than payroll during the period January 1, 2015 to December 31, 2015.

To assess the appropriateness of expenditures, we reviewed invoices, vendor lists and traced the expenditures to the general ledger. The appropriateness of those expenditures was evaluated on the basis of the grant agreements, applicable laws and regulations and LSC policy guidance.

To evaluate and test internal controls over the salary advances, contracting, property and equipment, internal management reporting and budgeting and payroll; we interviewed appropriate program personnel, examined related policies and procedures and selected specific transactions to review for adequacy.

To evaluate the adequacy of the cost allocation process, we discussed the cost allocation process for the scope period with grantee management and requested for review the grantee's written cost allocation policies and procedures as required by the LSC Accounting Guide. We tested the cost allocation amounts and reviewed the related reclassification entries using the information provided by the grantee.

Controls over derivative income were reviewed by examining current grantee practices and reviewing the written policies contained in the grantee's Accounting Manual.

The on-site fieldwork was conducted from February 22, 2016 through March 2, 2016. Our work was conducted at the grantee's program administration office in Memphis, TN and at LSC headquarters in Washington, DC. We reviewed documents pertaining primarily to the period January 1, 2015 through December 31, 2015.

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.

Memphis Area Legal Services, Inc.
Serving the Tennessee Counties of Shelby, Fayette, Lauderdale, and Tipton
malsi.org
An LSC Funded Organization

Harrison D. McIver III, Esq.
Executive Director

Mary L. Wolff, Esq.
Board President

June 7, 2016

John M. Seeba
Assistant Inspector General for Audit
Office of Inspector General
Legal Services Corporation
333 K Street, N.W., 3rd Floor
Washington, DC 20007-3558

Re: Draft Report Memphis Area Legal Services
RNO 643030
Report No. AU 16-XX

Dear Mr. Seeba:

Memphis Area Legal Services is in receipt of the draft report based upon the visit referenced above. Below, please find our response to same.

MALS is currently addressing the following recommendations in the manner outlined below:

Recommendation No. 1 – The Executive Director should either establish or update written policies for the following:

a. **Master Vendor List** – A policy has been drafted to present to the Board of Directors for review and approval at its next scheduled meeting in June 2016.
b. **Credit Cards** – An addendum has been drafted to present to the Board of Directors at its next scheduled meeting in June 2016 for review and approval.
c. **Contracting** – MALS is updating its current policy to address sole source contracts to be presented to the Board of Directors at its June 2016 for review and approval.
d. **Fixed Assets** – A policy has been drafted to present to the Board of Directors for review and approval at its next scheduled meeting in June 2016.
e. **Derivative Income** – A policy was drafted and presented to the Executive Committee of the Board of Directors in May 2016 and will be presented to the full Board at its June 2016 Board meeting.
f. **Budgeting** – A policy the outlines the budgeting process has been drafted for review and approval of the Board of Directors at its June 2016 Board meeting.

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g. **Employee Benefits** – Policy statements have been drafted for the LRAP (Lawyers Repayment Assistance Program) and cell phones. These will be submitted to the Board of Directors for review and approval at its June meeting; thereafter, they will be incorporated into the Employee Handbook.

Recommendation No. 2 – The Executive Director should ensure that a person independent of the purchasing process and accounts payable functions receives and review goods for their condition and completeness when they arrive.

Response: MALS has incorporated the Executive Assistant in the process to receive and examine the condition of goods, and check for completeness of orders received. The Executive Assistant will initial approval on the receipt form and then forward to financial administrator I for payment processing. This additional step in the purchasing process has been approved by the Executive Committee of the Board of Directors and will be presented for affirmation to the full Board at its next meeting in June 2016.

Recommendation No. 3 – The Executive Director should ensure that Supply Request forms are properly completed and approved prior to disbursements and credit card purchases.

Response: MALS will be especially watchful during the levels of approvals to ensure that the request forms are properly signed and dated for purchases prior to disbursements. Managers and both check signers will be careful in review of all documents prior to making disbursements to ensure they are properly completed with signatures and dates.

Recommendation No. 4 – The Executive Director should ensure that the process for each contract action is fully documented such as sole source justification and documentation of competition, if competitively bid. Documents should be maintained in the central file.

Response: MALS is updating its contract policy to include sole source guidelines. This update will be presented to the Board of Directors for approval at its June 2016 meeting. Competitive bids will now be kept in the central files with the vendors as payments are made.

Recommendation No. 5- The Executive Director should consider re-opening contracts to the public for bidding to ensure the grantee is receiving the best price and service available.

Response: MALS is currently in the process of re-bidding its contracts for its operating leases on the postage meter and copiers as recommended.

Recommendation No. 6-The Executive Director should update the written cost allocation policy to include a timeline for completion of all allocations within the accounting period.

Response: MALS financial staff is currently making all cost allocations minimally on a quarterly basis. This timeline will be included in the accounting manual.

If you need any additional information concerning plans mentioned above, feel free to contact Janese Perry, CFO at 901.255.3448 or jperry@malsi.org or me at 901.255.3447 or hdmciver@malsi.org.

Thank you.

Sincerely,

Harrison D. McIver, III
Executive Director/CEO

Cc: Justin Ross, Chairman MALS Board of Directors
Clay Purdom, Treasurer MALS Board of Directors
Janese Perry, CFO/HR Officer