Office of Inspector General
Legal Services Corporation

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September 28, 2016

Ms. Elizabeth Fritsch
Executive Director
Legal Aid of Southeastern Pennsylvania
625-627 Swede Street
Norristown, PA 19401-4801

Dear Ms. Fritsch:

Enclosed is the Office of Inspector General's (OIG) final report for our audit of Selected Internal Controls at Legal Aid of Southeastern Pennsylvania. Your comments are included in the final report as Appendix II.

The OIG considers your proposed actions to address Recommendations 1 through 8 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, 3, 5, 6, 7 and 8 will remain open until the grantee has updated its Accounting Manual and obtained the required Board of Directors' approval. Recommendation 2 will remain open until the grantee has provided the OIG documentation showing the property listings have been updated to include all required fields and are consistent among all locations. Recommendation 4 will remain open until the grantee has provided us documentation that the vendor list has been purged and updated.

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

Sincerely,

Jeffrey E. Schanz
Inspector General

LSC
America's Partner For Equal Justice

Enclosure

cc: Legal Services Corporation
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Lynn Jennings, Vice President
For Grants Management

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LEGAL SERVICES CORPORATION

OFFICE OF INSPECTOR GENERAL

FINAL REPORT ON SELECTED INTERNAL CONTROLS

LEGAL AID OF SOUTHEASTERN PENNSYLVANIA

RNO 339141

Report No. AU 16-08

September 2016

www.oig.lsc.gov

TABLE OF CONTENTS

INTRODUCTION 1
BACKGROUND 1
OBJECTIVE 2
AUDIT FINDINGS 2
WRITTEN POLICIES AND PROCEDURES 2
Recommendation 1 4
FIXED ASSETS 5
Recommendation 2 5
DISBURSEMENTS 6
Recommendation 3 6
Recommendation 4 6
CONTRACTING 7
Recommendation 5 8
Recommendation 6 8
GENERAL LEDGER AND FINANACIAL CONTROLS 8
Recommendation 7 10
Recommendation 8 10
SUMMARY OF GRANTEE MANAGEMENT COMMENTS 11
OIG EVALUATION OF GRANTEE MANAGEMENT COMMENTS 11
APPENDIX I – SCOPE AND METHODOLOGY I-1
APPENDIX II – GRANTEE MANAGEMENT COMMENTS II-1

INTRODUCTION

The Legal Services Corporation (LSC) Office of Inspector General (OIG) assessed the adequacy of selected internal controls in place at Legal Aid of Southeastern Pennsylvania (LASP or grantee) related to specific grantee operations and oversight. Audit work was conducted at the grantee's administrative office in Norristown, PA 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

Legal Aid of Southeastern Pennsylvania (LASP) is a non-profit Pennsylvania corporation committed to providing high quality civil legal services to low-income people, victims of domestic abuse and the elderly living in Bucks, Chester, Delaware and Montgomery counties. LASP is the primary provider of civil legal representation to low income families in the areas of domestic violence, mortgage foreclosures, bankruptcy, divorce, and elder law issues. LASP operates out of six offices staffed full-time in the four-county region.

LASP receives grants and contributions from a variety of sources including governmental agencies and private contributions. According to audited financial statements for the year ended June 30, 2015, the grantee received a total of $5,158,759 in LSC and non-LSC funding. Approximately 22 percent of the grantee's total funding was provided by LSC in the amount of $1,111,686. Approximately, 78 percent was non-LSC funding in the amount of $4,047,073.

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 and financial 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 general ledger and financial controls, credit cards, cash disbursements, contracting, fixed assets, and derivative income need to be strengthened or established 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 in the policies must be enhanced in the grantee's Accounting Manual.

General Ledger and Financial Controls Policy

The grantee's Accounting Manual contained documented policies and procedures relating to the general ledger and financial controls; however, it lacked details on how the accounting system provides for separation of receipts and disbursements of LSC and non-LSC funds as well as how physical safeguarding of cash receipts is ensured.

Section 2-1.2 of the Accounting Guide states the grantee should establish and maintain an accounting system to record grants, contracts and contributions separately. The Accounting Guide further states that because LSC requires separate disclosure as part of the financial statements, LSC recipients should maintain a fund-based accounting system, at least for LSC funds. In addition, the *Fundamental Criteria* states that financial controls should be established in order to safeguard resources.

Credit Card Policy

The grantee's Accounting Manual has a credit card policy in place that generally follows LSC's *Fundamental Criteria,* however, the policy needs to be strengthened to include the process and controls over issuance of credit cards. Those controls should include a documented credit card issuance process and procedures for acknowledgement of responsibility by cardholders. The credit card policy also needs to be updated in order to reflect the actual credit card spending limits, in practice, for each cardholder. The Accounting Manual states the credit card limit is $1,500; however, the credit card statements detail a spending limit of $2,500. The grantee needs to update its Accounting Manual to reflect actual credit card spending limits for its cardholders.

Chapter 3-6 (Fraud Prevention Guide) of the Accounting Guide stipulates that grantees should set credit card spending limits for its users. Properly controlling the issuance of credit cards through written policies reduces the potential for misuse and protects the grantee's resources.

Cash Disbursement Policy

LASP's Accounting Manual has a cash disbursement policy in place that closely adheres to LSC's *Fundamental Criteria*; however, in regards to purchasing approvals for office supplies, the policy needs to be updated to reflect the grantee's current practices. The purchasing policy states that purchases above $125 for office supplies should be approved by the Executive Director prior to ordering. However, LASP's Fiscal Director stated the grantee's practice is to obtain prior approval for office supply purchases over $250 and a verbal approval from an office manager if under $250.

Contracting Policy

The grantee's policies and procedures for contracting do not fully comply with all of the components of LSC's *Fundamental Criteria*. The grantee's Accounting Manual omitted information detailing types of contracts, contracting procedures for the various types of contracts, dollar thresholds, competition requirements, policies and procedures regarding documentation and filing of contracts, bids and quotes and other documentation related to contract actions.

Fixed Assets Policy

OIG review of the grantee's policies and procedures over fixed assets found they did not contain all the elements stated in LSC's *Fundamental Criteria.* The written policy included in the grantee's Accounting Manual omits the following with respect to fixed assets:

(1) prior approval from LSC is required for purchases over $10,000 with LSC funds for a property item;
(2) procedures and controls over the disposal of assets;
(3) the depreciation method used; and

(4) required elements in the property records including check number, location, salvage value, depreciation method, and identification number.

Derivative Income Policy

The grantee has no documented policies and procedures related to derivative income. The derivative income policy should include rental income 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 LSC grant. Currently, the only type of derivative income the grantee has obtained is interest income. Although the amount of interest income is minimal, the grantee should have a written policy in the Accounting Manual explaining the grantee's methodology with respect to the allocation of interest.

As to the policy and procedure deficiencies noted above, grantee management was not aware that its Accounting Manual required a significant level of detail in order to meet LSC *Fundamental Criteria* requirements. Grantee management acknowledged that its Accounting Manual is outdated and stated that it is currently being updated to reflect all practices in place including all information required by LSC's *Fundamental Criteria*.

Written policies and procedures serve as a method to document the design of controls and communicate them to the staff. Without detailed written procedures, there could be a lack of transparency and consistency in the application of the methodology, especially in cases of staff turnover. Approved, documented policies and procedures represent grantee management's intentions on the handling of processes and serve as a method of documenting the design of controls, communicating them to the staff and ensuring that proper controls are followed.

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

a. general ledger and financial controls;
b. credit cards;
c. cash disbursements;
d. contracting;
e. fixed assets; and
f. derivative income.

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

FIXED ASSETS

Missing Elements in Property Records

The OIG reviewed the grantee's internal controls over fixed assets and found that there were adequate controls in place to properly track its property, however, the grantee's property records contained deficiencies.

LASP's property record listing did not include all of the elements required by the *Fundamental Criteria*. The missing required elements were: (1) depreciation method, (2) salvage value, if any (3) check number and (4) estimated life.

LASP maintains a property spreadsheet detailing property located at the various LASP office locations. We found the following two deficiencies in those property records:

> (1) the property spreadsheet for the different office locations was not consistent and did not have the same fields, therefore, the spreadsheets captured different information about the property at the various locations.
>
> (2) some fields in the property spreadsheets were incomplete and lacked the necessary information. Elements such as tag numbers, model numbers and serial numbers were not consistently completed.

Section 3-5.4 (c) of the LSC Accounting Guide states: "Property purchases should be recorded in a property subsidiary record. The property record should include a description of property, date acquired, check number, original cost, funding source, estimated life, depreciation method, identification number and location."

The Fiscal Director was unaware that all property record fields are required, and also overlooked the fact that property records for the different office locations did not capture the same information. In addition, the Executive Director explained that their accounting department is limited to two people with a significant work load.

Failure to maintain adequate property records could result in the inability to fully account for assets purchases, support depreciation amounts and property asset balances. An inadequate property record could result in difficulty tracking items with no serial numbers or user identifications, items being misplaced, and inconsistent recording of assets based on location.

Recommendation 2: The Executive Director should strengthen fixed asset practices by updating the grantee's property records with adequate information, ensuring all fields are present and completed and the same information is being captured at all office locations.

DISBURSEMENTS

The OIG reviewed 84 disbursements totaling $56,616.49 and 14 credit card statements with 23 transactions totaling $13,739.15. In general, there were adequate controls over disbursements and they were in accordance with grantee policy and LSC regulations, except for the prior approval requirements.

Lack of Prior Approval of Expenditures

The OIG found three disbursements totaling $2,197.75 and four credit card transactions totaling $1,317.02 where purchases were not preapproved as required by the grantee's disbursement approval policy. None of the seven expenditures had the required preauthorization forms and all individual purchases were greater than the $250 threshold.

Grantee management stated that although their policy requires preauthorization forms to be completed for purchases over $125, this has not been the practice. The grantee's practice has been to require approval for expenditures above $250. According to discussions with the Executive Director, the threshold for preapproval needs to be updated in the written policy to $250.

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 LASP Accounting Manual states requests for goods and materials purchases must be made to the Executive Director prior to ordering.

Master Vendor List Not Purged.

Our review of the process and controls over the master vendor list revealed that the list has never been updated. LASP's Fiscal Director is responsible for maintaining the list. The Fiscal Director stated that she occasionally reviews the list, but has never purged the list or updated it to reflect inactive vendors. She stated that she did not see the need to routinely purge the list since disbursements to vendors are reviewed by her and approved by LASP's Executive Director prior to payments being made. Adequate maintenance of the Master Vendor list reduces potential for fraudulent payments made to fictitious vendors. Routine purging of the vendor list will help ensure that only active and authorized vendors are paid.

Recommendations: The Executive Director should:

Recommendation 3: ensure purchases are approved in accordance with the grantee's written policy or update the threshold amount in the policy that requires preapproval.

Recommendation 4: ensure routine updating of the Master Vendor List to reflect current vendors and is adequately maintained.

CONTRACTING

Lack of Supporting Documentation

OIG review of 13 contracts found that all of the contracts were missing some type of supporting documentation, such as the original contract, bids, sole source justifications, documentation of modifications and extensions, and documented agreements.

Of all the contracts reviewed, LASP's Fiscal Director stated she could only remember one that she was sure was competitively bid; however, the bids were not on file. For the other two contracts that should have been competitively bid because they exceeded the $5,000 amount, which triggers the competitive bidding process, she stated the services had been in effect for so long, there was no way of knowing if they were actually competitively bid or not.

The OIG found that all 13 contracts received the expected deliverables; however, approvals from the Executive Director for seven contracts could not be determined because the contracts were not on file.

The following table summarizes the thirteen contracts sampled:

Contracts	Total Amount Disbursed from 1/1/2015 to 05/31/2016	Type of Contract	Missing Documentation
Temple University Harrisburg NEST	6,000.00	Competitive Bid	Bids
Tech Wise	7,139.25	Unknown (see note)	Bids
Lexis Nexis	34,837.71	Unknown	Bids
William Galinas, Attorney	6,962.20	Sole Source	Sole Source Justification
Canon	7,976.27	Unknown	Contract Actions
Great America Leasing Corporation	3,889.60	Unknown	Contract Actions
Beth Anderosky, Janitor	$1,950.00	Sole Source	Contract
Chris Horrocks, Janitor	$1,950.00	Sole Source	Contract
Both is Better, LLC	$2,131.00	Sole Source	Contract
Nicole Long, Janitor	$1,320.00	Sole Source	Contract
Susan J. Lucas, Accountant	$1,770.00	Sole Source	Contract
Patricia A MacCorkle,Janitor	$ 980.00	Sole Source	Contract
LaMar Tyler, Janitor	$1,800.00	Sole Source	Contract

Note: We state "unknown" here because the grantee does not have the required documentation on file for us to determine whether the contract was competed or awarded sole source.

Lack of Contracts

The OIG's review found that seven vendors did not have a documented contractual agreement with the grantee for services provided, as shown in the table above. Although the costs involved were not high dollar amounts, the business arrangements were for recurring services; as such, the terms and price should have been documented in a contractual agreement.

Grantee management stated there were no documented contractual agreements with those vendors because the payments to these vendors did not meet the contract threshold to be competitively bid or require sole source justification. Grantee management stated it did not think it necessary to have written agreements with these vendors because the grantee knew what services were being provided and the costs associated with the vendors were minimal individually.

Section 3-5.16 of the Accounting Guide, Contracting, states 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.

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 ensure that:

Recommendation 5: the process for each contract action is fully documented such as sole source justification and documentation of competition, if competitively bid.

Recommendation 6: contracts are written and maintained for all business arrangements, especially those that are recurring in nature. The contracts should state the terms and price of the services agreed upon by both parties and be filed in a central location.

GENERAL LEDGER AND FINANCIAL CONTROLS

Review and Approval of Bank Reconciliations

The OIG auditors randomly selected a sample of 10 monthly bank reconciliations from the operating account, payroll account, sweep account, IOLTA/AJA account and client trust account over the audit period to ensure that bank reconciliations were performed and reviewed in a timely manner.

The OIG determined that of the ten bank account reconciliations reviewed:

- approval signatures on four reconciliations were not dated; therefore, we could not tell when they were approved.
- for three reconciliations the preparer did not date the signature; therefore, we could not tell when they were prepared.
- two reconciliations were not approved by the Executive Director in a timely manner. The approval was made over three months after the reconciliation was performed.
- one reconciliation was not approved by the Executive Director.

Section 3-5.2 (d) of the LSC Accounting Guide stipulates that reconciliation of bank statements to the general ledger should be performed monthly by persons independent of cash keeping duties, check signing duties and cash bookkeeping duties. The reconciliation procedure is a fundamental control technique and failure to use it is an internal control weakness, especially in an environment where full segregation of duties is not practicable.

LASP's Accounting Manual states that responsibility for reconciliations of all statements shall be entrusted to the Fiscal Director. It further states the Fiscal Director shall sign and date the reconciliations, then present them for review to the Executive Director.

The Fiscal Director stated that the exceptions were most likely caused by a management oversight.

Proper reconciliation procedures will substantially increase the likelihood of irregular disbursements and recording errors being discovered on a timely basis. The reconciliation procedure is a fundamental control technique and important for establishing a solid internal control environment.

Outstanding Checks

The grantee's written policies and procedures over outstanding checks are in accordance with the *Fundamental Criteria*. However, the OIG found that bank reconciliations for the operating account in November of 2015 and the payroll account in February of 2016 had a total of nine checks outstanding for more than six months.

According to the grantee's Accounting Manual, outstanding checks that have not been cashed for a period of six months or one year from the original draft date shall be deemed "stale" and the check will be voided. The LSC Accounting Guide, Appendix VII also stipulates that grantees investigate and resolve the reasons for checks outstanding over six months.

The Fiscal Director stated that although the grantee does have policies and procedures over handling outstanding checks they are not always being followed by management. The Fiscal Director stated she was not sure how to address outstanding checks that do not meet the threshold for the state escheat process. The Fiscal Director stated that grantee management will determine the best way to handle outstanding checks for the future.

Outstanding checks present a lack of adequate control over financial transactions and increase the possibility that frauds or errors will be undetected.

Recommendations: The Executive Director should:

Recommendation 7: enforce the grantee's current policies and procedures by ensuring that bank reconciliations are performed monthly, documented with a signature and date, and reviewed and approved by a responsible individual.

Recommendation 8: enforce the grantee's current written policies and procedures on handling outstanding checks.

SUMMARY OF GRANTEE MANAGEMENT COMMENTS

Grantee management agreed with all findings in the report and accepted all eight 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, 7 and 8 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 1,3,5,6,7 and 8 will remain open until the grantee has updated its Accounting Manual and obtained the required Board of Directors' approval. Recommendation 2 will remain open until the grantee has provided the OIG documentation showing the property listings have been updated to include all required fields and are consistent among all locations. Finally, Recommendation 4, related to purging the vendor list, will remain open until the grantee has provided documentation that the vendor list has been purged and updated.

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 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 84 disbursements and credit card transactions totaling $56,616.49. The sample represented approximately 2 percent of the $2,784,851.35 disbursed for expenses other than payroll during the period January 1, 2015 to May 31, 2016.

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 on the basis of the grant agreements, applicable laws and regulations and LSC policy guidance.

To evaluate and test internal controls over 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 June 20, 2016 through June 24, 2016. Our work was conducted at the grantee's program administration office in Norristown, PA and at LSC headquarters in Washington, DC. We reviewed documents pertaining primarily to the period January 1, 2015 through May 31, 2016.

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.

LASP Legal Aid of Southeastern PA

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Executive Director
Elizabeth W. Fritsch, Esq.

Deputy Director
Kesha James, Esq.

Legal Aid of Southeastern Pennsylvania
Management's Reponses to Recommendations on Selected Internal Controls

Recommendation 1
Legal Aid of Southeastern Pennsylvania (LASP) agrees with OIG's assessment that the written policies and procedures should be strengthened. LASP has already begun updating the Fiscal Policy Manual to more adequately describe processes and controls in sufficient detail and in accordance with 2 CFR Part 200, LSC's Accounting Guide, and LSC's Fundamental Criteria.

Recommendation 2
LASP agrees with OIG's assessment that the property records do not include all of the necessary elements. The Fiscal Director has devised a plan to update property records with adequate information consistent across all locations.

Recommendations 3 & 4
LASP agrees with OIG's assessments regarding disbursements. Part of LASP's fiscal policy revision includes increasing the threshold amount for preapprovals. Also, the Fiscal Director has begun to routinely purge the Master Vendor List.

Recommendations 5 & 6
LASP agrees with OIG's assessments regarding contracting. Part of LASP's fiscal policy revision includes strengthening the procurement policy in accordance with 2 CFR Part 200 and LSC's Accounting Guide Section 3-5.16.

Recommendations 7 & 8
LASP agrees with OIG's assessments regarding the timeliness of bank reconciliations and outstanding checks. LASP has already addressed both issues in revisions to the Fiscal Policy Manual.