Office of Inspector General
Legal Services Corporation

Inspector General
Jeffrey E. Schanz

3333 K Street, Nw; 3rd Floor
Washington, DC 20007-3558
202.295.1660 (p) 202.337.6616 (f)
www.oig.lsc.gov

March 28, 2017

Ms. Barbara Laur
Executive Director
Neighborhood Legal Services Program of DC
680 Rhode Island Ave, NE
Washington, DC 20002

Dear Ms. Laur:

Enclosed is the Legal Services Corporation's (LSC) Office of Inspector General's (OIG) final report for our audit on Selected Internal Controls at Neighborhood Legal Services Program of DC. Your comments are included in the final report as Appendix II.

The OIG considers the proposed actions to Recommendations 1, 2, 3, 5, 6, 7, 8, 9, 10, 11, 13, 14, 15, 16, 17, 18, 19, 20, 21, and 22 as responsive. The actions planned by grantee management to address the issues and revise and updated its Accounting/Finance Policies and Procedures Manual should correct the issues identified in the report.

However, Recommendation 1 will remain open until the grantee's Accounting/Finance Policies and Procedures Manual has obtained the required Board of Directors' approval. Recommendations 2, 16, 17, and 18 will remain open until further supporting documentation is provided.

The OIG accepts the stated actions for Recommendations 3, 5-11, 13, 14, 15, 19-22 and they are considered closed.

The grantee' comments were not responsive to Recommendations 4 and 12. The grantee needs to provide more specific information to address the recommendations. The OIG is referring these recommendations to LSC management for resolution.

Please provide us with your response to close out the five open recommendations along with the revised Accounting/Finance 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 2017.

Sincerely,

Jeffrey E. Schanz
Inspector General

Enclosure

cc: Legal Services Corporation
Jim Sandman, President

Lynn Jennings,
Vice President for Grants Management

Neighborhood Legal Services Program of DC
Blake A. Biles, Esq.
Anne M. Ford
Board Co-Chairpersons

Sent by E-mail to Board of Directors
Dwight L. Ausbrooks, Sr.
Allison C. Binney, Esq.
Iris M. Green, Esq.
Johnny M. Howard, Esq.
Eric Humes
Dr. Jimmie C. Jackson
David S. Molot
Amy L. Neuhardt
Bingham B. Leverich, Esq.
Sara B. Rearden, Esq.
Paula D. Scott, Esq.
Dorothy Wilson
Gloria Jurado
Brooks Smith

LEGAL SERVICES CORPORATION

OFFICE OF INSPECTOR GENERAL

FINAL REPORT ON SELECTED INTERNAL CONTROLS

NEIGHBORHOOD LEGAL SERVICES PROGRAM OF THE DISTRICT OF COLUMBIA

RNO 309080

Report No. AU 17-06

March 2017

www.oig.lsc.gov

TABLE OF CONTENTS

INTRODUCTION **1**
BACKGROUND **1**
OBJECTIVE **2**
AUDIT FINDINGS **2**

Written Policies 2
Recommendation 1 4

Accounting System 4
Recommendation 2 4

Cost Allocation 5
Recommendation 3 6
Recommendation 4 6

Contracting 6
Recommendation 5 7
Recommendation 6 7
Recommendation 7 7
Recommendation 8 7

Disbursements 7
Recommendation 9 9
Recommendation 10 9
Recommendation 11 9

Debit Cards 9
Recommendation 12 10
Recommendation 13 10
Recommendation 14 10

Payroll 10
Recommendation 15 11

Fixed Assets 11
Recommendation 16 12
Recommendation 17 12
Recommendation 18 12

Segregation of Duties 12
Recommendation 19 13

General Ledger and Financial Controls 13
Recommendation 20 14
Recommendation 21 14
Recommendation 22 14

SUMMARY OF GRANTEE MANAGEMENT COMMENTS...................... 15
OIG EVALUATION OF GRANTEE MANAGEMENT COMMENTS 15
APPENDIX I – SCOPE AND METHODOLOGY 16
APPENDIX II - GRANTEE MANAGEMENT COMMENTS....................... 17

INTRODUCTION

The Legal Services Corporation (LSC) Office of Inspector General (OIG) assessed the adequacy of selected internal controls in place at Neighborhood Legal Services Program of the District of Columbia (NLSP or grantee) related to specific grantee operations and oversight. Audit work was conducted at the grantee's administrative office and at LSC headquarters, both 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 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

Neighborhood Legal Services Program of the District of Columbia (NLSP) was incorporated under the provisions of the District of Columbia Non-Profit Corporation Act. NLSP provides free civil legal services to low income residents of the District of Columbia. NLSP's assistance preserves safe and affordable shelter, stabilizes family relationships, protects victims of domestic violence, secures access to healthcare and public benefits and reduces barriers to employment for its clients.

During the scope of our audit, NLSP's Executive Director resigned to accept a position at a local university and an Interim Executive Director was in place during the on-site fieldwork; a new Director of Finance and Administration was also hired. Being new to the organization, they were both unaware of certain processes prior to accepting their positions. The Interim Executive Director stated they are aware of changes that need to be made and are working to build a robust accounting system to better support NLSP's growing, diversified funding base.

According to the audited financial statements for December 31, 2015, LSC provided 51 percent of the grantee's funding, amounting to $754,494. The other major funder is the DC Bar Foundation.

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 cash disbursements, credit/debit cards, cost allocation, contracting, fixed assets, derivative income, employee benefits, payroll, general ledger and financial controls and internal reporting and budgeting. While some of the controls were adequately designed and properly implemented as they relate to specific grantee operations and oversight, many controls need to be strengthened and formalized in writing. The following areas needed improvement:

WRITTEN POLICIES

We examined NLSP's Accounting/Finance Policies and Procedures Manual for cash disbursements, credit/debit cards, cost allocation, contracting, fixed assets, derivative income, employee benefits, payroll, general ledger and financial controls, and internal reporting and budgeting. While some of the areas included adequate procedures, other areas need to be enhanced, including:

AREA	CONDITION	EFFECT	CRITERIA
Contracting	The contracting policy does not include detailed procedures for various types of contracts with those specific contracting policies and procedures regarding documentation and filing of the contracts with the bids, quotes and other documentation related to contract actions.	Without documented policies and procedures for all types of contracts, contracts may be subject to fraud and/or abuse.	Refer to Section 3-5.16 of the LSC *Fundamental Criteria*
Derivative Income	The derivative income policy does not discuss how rent, proceeds from the sale of assets, interest income, and other compensation should be allocated back to their funding source.	Without detailed written policies and procedures, there could be a lack of transparency and consistency in the allocation of derivative income, especially in the case of staff turnover.	Refer to Section 2-2.7 of LSC's Accounting Guide

Credit/Debit Cards	The credit/debit card policies lack information regarding the following: • Setting of maximum dollar thresholds. • Prohibited personal use • Cash advances or ATM withdrawals. • Timeliness. • Terminating access to employees who leave the organization or transfer to positions that no longer require debit/credit cards. • Disallowed charges.	Without explicit written policies and procedures, there could be misunderstandings, inefficient operations, or the potential for fraud to occur.	Refer to Internal Controls included within LSC's Accounting Guide Appendix VII Section G3
Disbursements	There was no written policy included within the grantee's Accounting/Finance Policies and Procedures Manual prohibiting the signing of blank checks.	Not having written policies prohibiting the signing of blank checks could result in fraud, waste, and abuse.	Refer to Section 3-5.4(b) of LSC's *Fundamental Criteria*
Employee Benefits	There is a written policy over salary advances, however, the policy does not specify procedures in regards to management requests such as for the Executive Director.	Without detailed written policies and procedures over grantee management's salary advance, requests may result in uncollectible salary advances.	Refer to Section 3-5.5(b) of LSC's *Fundamental Criteria*
Fixed Assets	There is no written policy for disposal of fixed assets and adjusting entries in cases of theft or loss of fixed assets.	Disposal and fixed assets adjustments oversight policies enable the grantee to safeguard and fully account for the assets sold (disposed).	Refer to Property Acquisition and Management Manual Sections 6 and 7
General Ledger/Financial Controls	The grantee's Accounting/Finance Policies and Procedures Manual lacks the following information: • Timeliness for cash receipts deposits. • Detailed review of bank reconciliations.	Not having an Accounting Manual that complies with the Fundamental Criteria and having explicit written policies and procedures could lead to misunderstandings, less than efficient operations, or the potential for fraud to occur.	Refer to Sections 3-5.1, 3-5.2(d) and 3-5.4 of LSC's *Fundamental Criteria*
Cost Allocation	There is no written policy for LSC unallowable expenses.	Without a specific list of LSC unallowable expenses, there is an increased risk of LSC funds being used to pay for unallowable expenses.	Refer to 45 CFR § 1630.

Being new to the organization, management was unaware of why written policies and procedures were not included within NLSP's Accounting/Finance Policies and Procedures Manual. The Accounting Guide, 3-4, stipulates that each recipient must develop a written accounting manual that describes the specific procedures to be followed by the recipient in complying with the *Fundamental Criteria of an Accounting and Financial Reporting System (Fundamental Criteria)* contained in the LSC Accounting Guide.

Recommendation 1: The Interim Executive Director should ensure that all written policies and procedures are included within the grantee's Accounting/Finance Policies and Procedure Manual and that they adequately describe the processes and controls in sufficient detail and in accordance with LSC's Accounting Guide and *Fundamental Criteria*.

ACCOUNTING SYSTEM

The NLSP accounting system's "class" or funding source is not being used. As explained by the Director of Finance and Administration, NLSP's QuickBooks accounting system is not set up by funding source or cost centers. Due to the class or funding source not being used in the accounting system, we noted the following:

CONDITION	EFFECT	CRITERIA
We attempted to trace allocations for the quarter to the general ledger and found that the quarterly allocations are not traceable to the general ledger. Therefore, we were unable to determine whether the allocations were actually performed; whether their methodology was consistent; and if LSC was charged its proper and equitable share of costs incurred by the grantee.	Without an audit trail, it is difficult to determine or test whether direct cost allocations are performed accurately.	Refer Section 2-5 of LSC's Accounting Guide and Section 3-5.8 of LSC's *Fundamental Criteria*
While monthly management reports contain budget versus actual information, they do not track revenue and expenses fully by funding sources.	The consolidated report lacks the detail necessary for proper analysis and control of cost center or program spending.	Refer to Section 2-4.1 of LSC's Accounting Guide
Our review of the grantee's annual budget noted the budgets prepared by management are approved by the Board, however the budget is not built from cost centers or funding sources.	Without adequate budgeting and projecting tools, management may not be able to adequately control and plan the program expenditures, including the various funding sources.	Refer to Section 3-5.10 of LSC's *Fundamental Criteria*

Recommendation 2: The Interim Executive Director should have the accounting system set up to allocate expenses by funding source so as to allow the grantee to produce budgets derived by cost centers, generate flexible reports by funding source detail and provide an adequate audit trail.

COST ALLOCATION

The OIG examined the grantee's Accounting/Finance Policies and Procedures Manual and practices and noted that the documented policies and grantee's practices, related to cost allocation, were not in accordance with LSC requirements. We were unable to determine whether their allocation plan is reasonable and timely and whether their methodology was consistent and equitable as the grantee's accounting system does not provide an audit trail to perform testing.

Written Methodology

During our audit, we noted NLSP did not have a documented allocation methodology. The Director of Finance and Administration did not have detailed, formal written procedures for the grantee's accounting methodology to explain where costs originate.

Per LSC's *Fundamental Criteria* Section 3-5.9, common expenses shall be allocated among the funding 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. Further, the allocation formula should be adequately documented in writing with sufficient detail for the auditor, LSC, OIG, GAO, and others, to easily understand, follow, and test the formula.

Without a detailed allocation methodology, it is difficult to determine or test whether direct cost allocations are performed accurately, and to assure that LSC and other funding sources receive their fair and equitable share of costs incurred by the grantee.

Personnel Costs Audit Trail

Based on our review, we found that the grantee's accounting system does not provide an audit trail to perform testing of allocated costs. The grantee does not allocate individual transactions across funding sources. Rather, the grantee's cost allocation is performed on a quarterly basis in a separate spreadsheet according to the percentage rate of the total salary charged to each funding source.

We requested supporting documents to test direct personnel costs based on the hours worked or time entry in the case management system for selected employees. The grantee had difficulty pulling records of time entries from the timekeeping system and could not provide supporting documentation. Based on this information, we were not able to test the methodology used for direct cost allocation and determined that reports from the case management system are not reliable to determine whether the grantee is allocating direct personnel costs accurately to its related funding sources.

Overall, the grantee did not maintain an audit trail of the expense distribution. Therefore, the OIG could not perform test work to determine whether LSC received its fair and equitable share of costs incurred by the grantee. LSC Grant Assurance No. 18 for Calendar Year 2015 funding stipulates that grantees must maintain original (or digital images of) financial records and supporting documentation for LSC to audit and determine whether the costs incurred and billed are reasonable, allowable and necessary under the terms of the grant.

LSC's *Fundamental Criteria* Section 3-5.9 states common expenses shall be allocated among the sources on the basis agreed by the applicable funding organizations, and in the absence of the approved methods, the allocation should be fair, consistent, and in an equitable manner to the individual cost centers, and funds. Further, the allocation formula should be adequately documented in writing with sufficient detail for the auditor, LSC, OIG, GAO and others, to easily understand, follow, and test the formula.

Without a reliable reporting system, it is difficult to determine or test whether direct cost allocations are performed accurately.

We are referring this issue to OCE for follow-up to ensure that the allocation methodology is properly documented and working as designed.

Recommendations: The Interim Executive Director should:

Recommendation 3**:** establish a fair, transparent, consistent and systematic cost allocation methodology in accordance with LSC requirements. In addition, the allocation methodology should be documented in the grantee's Accounting/Finance Policies and Procedures Manual and written with sufficient detail for the auditor, LSC, OIG, GAO and others to easily understand, follow, and test the formula.

Recommendation 4**:** ensure an audit trail is established with supporting documentation for all allocation schedules, formulae and transactions allocated to funding sources.

CONTRACTING

OIG's review of NLSP's written policies and procedures for contracting determined that their policies need to be enhanced to adhere to LSC's *Fundamental Criteria.* The OIG reviewed ten vendor files and tested them for compliance with the *Fundamental Criteria*.

Of the ten vendor files reviewed, we noted inadequate contracting documentation as follows.

- For six of the ten vendor files selected, management was unable to locate a documented contractual agreement with the vendor for services provided. While some of the costs involved with the services were not high dollar amounts, the business arrangements were for recurring services and therefore, the terms and price should have been documented in a contractual agreement.
- Seven of the ten vendor files did not have supporting documentation of how the vendor was selected.
- For three of the ten vendors, we noted the contract/agreement was greater than $10,000 which required Board approval, according to NLSP policies. We were not provided support of recommendation provided to the BOD for one of the vendors and documentation of BOD approval for two of the vendors.

- One of the four contracts received did not include a start date and payments made per the invoice selected did not agree with the rates included within the contract.

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

NLSP noted that due to new staffing, they were unable to locate some of the contracts, agreements or supporting documentation. Management was also unable to determine why some contracts were not complete or updated.

Failure to maintain a centralized filing system could result in less control and security over the contracting documentation. Management also runs the risk of lost or misplaced contracting information and noncompliance with LSC regulations on contract maintenance. 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.

Recommendations: The Interim Executive Director should ensure that:

Recommendation 5: contracts 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 6: the process for each contract action is fully documented in writing such as sole source justification and documentation of competition, if competitively bid.

Recommendation 7: all supporting documentation is maintained for recommended selections provided to the Board as well as the Board approval.

Recommendation 8: a centralized filing system for all contracts is maintained and contains all pertinent documents related to the solicitation of bids, including receipt and evaluation of bids, sole source justification, vendor selection, a signed contract or agreement, and any agreed upon modifications to a contract or agreement.

DISBURSEMENTS

The OIG randomly selected a sample of 70 disbursements totaling $110,805. It was determined that all disbursements tested were allowable; however, some lacked appropriate approvals, adequate support and allocation amounts.

Inadequate Supporting Documentation

We found that seven disbursements tested totaling $15,062 lacked proper supporting documentation.

- Four disbursements did not include supporting documentation, just the check stub.
- Three disbursements included a request for payment but no supporting receipts.

Section 3-5.4(c) of the *Fundamental* Criteria states an organized method shall be established to accumulate and file all documents relating to a particular disbursement for future reference.

Inadequate documentation can result in unauthorized disbursements.

Inadequate Approval

For 45 disbursements totaling $71,202, prior approvals could not be verified due to:

- invoices with no approval signature or date;
- invoices with an approval signature but no date; and
- check stubs were handwritten and did not include a check date.

An additional three disbursements totaling $3,942 were approved after the check was written.

Section 3-5.4(a) of the *Fundamental Criteria* stipulates that approvals should be required at an appropriate level of management before a commitment of resources is made**.**

Failure to obtain prior approval for purchases may result in purchases made without the knowledge of appropriate management or at unacceptable prices or terms.

Preventive Controls for Duplicate Payments

There is lack of control over disbursements to prevent duplicate payments as some invoices do not indicate that they have been paid with a stamp or other marking to indicate payment was made. Inadequate document controls may result in duplicate payments to vendors.

The *Fundamental Criteria* Section 3-5.4(a) states documents should be marked paid or otherwise canceled to avoid duplicate payment. The check number and pay date should also be noted on the invoice or other supporting documentation.

The Director of Finance and Administration was unsure as to why this occurred during the audit scope period and as a result, implemented a process by stamping “entered” across the invoices. The OIG sampled four additional disbursements outside of the audit scope and concluded that these procedures are currently being followed.

Recommendations: The Interim Executive Director should ensure that:

Recommendation 9: all disbursements have the proper supporting documentation so that purchases, reimbursements and payments are justified.

Recommendation 10: pre-approvals for purchases, even office supplies and other minor purchases, are documented and retained.

Recommendation 11: staff continue to mark disbursement documents as paid to avoid duplicate payment.

DEBIT CARDS

The OIG tested 12 debit card transactions totaling $7,540. Our review and testing of the grantee's practices over credit cards revealed additional controls that need strengthening.

Restricted Usage

The grantee has one debit card, which is in the name of the prior Executive Director. The Director of Finance and Administration stated that the prior Executive Director's name is still on the card due to the card never going outside of the office and NLSP's management felt there was no need to get a new card with the current Executive Director's name as she is only an interim appointment.

There is also no set limit to the number of users that can use the debit card. Physical access is granted to each staff member requesting to make a purchase using the card. According to the Director of Finance and Administration, the debit card stayed in the Executive Director's possession who had ultimate authority in distribution and approval.

The LSC Accounting Guide Chapter 3-6 notes as a key practice, grantee's should limit credit card users and set credit card spending limits.

There is an increased risk of unauthorized purchases or resources being wasted when terminated employees' cards are not cancelled or there is no limit to the number of users on the debit card.

Inadequate Support and Approvals

The OIG's testing of internal controls over debit cards determined the following:

- Seven transactions had no documented prior approval, four of the transactions were purchases made by the previous Executive Director.
- For one of the four debit card purchases made by the Executive Director, we determined there should have been a second approval based on written disbursement requirements for purchases of $5,000 or greater.
- Funding source allocations were not documented.
- Memos were not attached with receipts as required by the grantee's Accounting/Finance Policies and Procedures Manual.

The Director of Finance and Administration noted that supporting documentation was missing from the grantee debit card purchases but did not know why no other support was kept with the receipts. She stated that prior approval may have been verbal or emailed, being that the Executive Director kept the card on hand at the time and had ultimate approval before allowing use of the card.

Section 3-5.4(c) of the *Fundamental Criteria* states an organized method shall be established to accumulate and file all documents relating to a particular disbursement for future reference. Section 3-5.4(a) of the *Fundamental Criteria* stipulates that approvals should be required at an appropriate level of management before a commitment of resources is made.

Lack of adequate supporting documentation could result in unsupported purchases and unauthorized disbursements. A failure to follow the purchase approvals process may result in purchases made without the knowledge of appropriate management or at unacceptable prices or terms.

Recommendations: The Interim Executive Director should:

Recommendation 12: obtain a new card containing the name of someone in a more permanent position.

Recommendation 13: enhance the debit card policy to include:

- instructions on documenting required approvals and procedures involving the use of debit cards which are in line with disbursement requirements; and
- ensure that a limit is set to the number of users that access the card, possibly restricting usage to the Director of Finance and Administration.

Recommendation 14: ensure all disbursements, including debit card expenses, have the proper supporting documentation so that purchases, reimbursements, and payments are fully supported.

PAYROLL

The OIG reviewed a total of 154 timesheets from six pay periods. We noted that 76 timesheets were processed without approval of the employees' supervisor. In addition, one of three leave requests reviewed did not document approval of the employee's supervisor.

According to the Director of Finance and Administration, the majority of the timesheets were approved through email.

Section 3-5.5 of the *Fundamental Criteria* notes an attendance record or time record shall be maintained for each employee and shall be approved by the employee's supervisor. Timesheets or time records including leave requests should be approved by an immediate supervisor to reduce the potential for time and attendance fraud. In addition, inadequate oversight may result in an employee receiving unauthorized leave and/or payments.

Recommendation 15: The Interim Executive Director should ensure that management follows its own timesheet approval procedures by formally reviewing and approving timesheets by signing the paper timesheet as well as keeping records of approval in cases where approval was provided in the form of an email.

FIXED ASSETS

As a result of our review of the grantee's written policy over fixed assets, we determined that it is for the most part, comparable to LSC's regulations and guidelines. However, as a result of our test work we found that, in practice, the grantee's internal controls over purchasing, recording, physical inventory, and disposal of fixed assets are inadequate and do not fully adhere to LSC regulations and guidelines or the grantee's written policy.

Incomplete Fixed Asset Records

NLSP uses its depreciation schedule as property subsidiary records. The property record did not contain the following required elements:

- check number
- fair value (if donated)
- method of valuation (if donated)
- salvage value if any
- funding source
- estimated life
- tag/identification number
- location

The LSC *Fundamental Criteria* Section 3-5.4 stipulates that the property record include all the information listed above. In addition, it states the property subsidiary record must agree with the general ledger property accounts.

Fixed Assets Not Reconciled

The grantee has a documented policy to perform a physical inventory at least every two years. The grantee provided the LSC OIG with 2013 and 2014 physical inventory and 2015 depreciation record. We noted the following in regards to the physical inventory documentation received:

- The grantee's only fixed asset record is the depreciation schedule and is not reconcilable to the physical inventory record because the depreciation schedule does not include the tag numbers assigned to each fixed asset.
- Physical inventory was not performed at all its locations during both of the years provided.
- All the items included on the physical inventory have a cost less than $5,000 and therefore did not include capitalized items.

The Director of Finance and Administration stated she was not aware of whether the results of the physical inventory were reconciled with the fixed asset records in the past.

The LSC Accounting Guide, Section 2-2.4 states that a physical inventory shall be taken and the results reconciled with property records at least once every two years. Any differences between quantities shall be determined by physical inspection and those shown in the accounting records investigated to determine the causes of difference, and the accounting records should be reconciled to the results of the physical inventory with an appropriate note included in the financial statements.

Properly accounting for fixed assets enables the grantee to safeguard and fully account for the assets purchased and support reconciliations so that property balances are accurate. In addition, comparing the physical inventory count to property records help identify any assets that need to be added or taken off the property records.

Sensitive Electronic Items

During the audit, we learned that NLSP does not have a tracking system for sensitive electronic items. Inspection of the sensitive electronic items determined:

- one of the six laptops inspected was not properly tagged, and
- two laptops were not included in the physical inventory performed in 2014.

NLSP staff stated they were not aware of the two laptops so they were missed in the physical inventory, and were unsure why the other laptop was not tagged.

Section 2-2.4 of the LSC Accounting Guide notes grantees should be mindful of items that may contain sensitive information (for example, a computer with client confidential information) with values lower than $5,000 and the need to inventory these items and dispose of them appropriately.

Failure to physically tag and track IT equipment with sensitive information increases the risk of loss, theft and/or such information being compromised.

Recommendations: The Interim Executive Director should ensure that:

Recommendation 16: there is a subsidiary property record that includes all the required property criteria in accordance with the LSC *Fundamental Criteria*.

Recommendation 17: a physical inventory count is conducted every two years including all grantee offices, capitalized items, and reconciliation to the accounting property records in accordance with LSC guidelines.

Recommendation 18: policies and procedures are developed and implemented to track IT equipment, such as laptops, which may contain sensitive information.

SEGREGATION OF DUTIES

The grantee's Director of Finance and Administration is responsible for entering data into the accounting system and is also responsible for depositing checks. The Accounting Guide identifies segregation of duties as a significant component of an adequate internal control structure. Accounting duties should be segregated to ensure that no individual simultaneously has both physical control and record keeping responsibility for any asset, including 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.

The Director of Finance and Administration was unaware that she could not deposit the checks and enter the data into the system. NLSP has a desktop deposit scanner that does deposits for them. When the machine was not working, another staff member would physically take deposits to the bank. Once the machine was properly working, the Director of Finance and Administration felt it was more effective to make the deposits using this method.

Lack of segregation of accounting duties provides opportunity for fraud to occur and go undetected. Persons having dual responsibilities like records maintenance and deposits could result in an individual cashing a check or money order and then adjusting the records to cover irregularities.

Recommendation 19: The Interim Executive Director should ensure that proper segregation of duties are in place to ensure the staff member responsible for making deposits does not also have access to the accounting system.

GENERAL LEDGER AND FINANCIAL CONTROLS

Bank Reconciliations

The OIG randomly selected the months of October 2015 and June 2016 to test that bank reconciliations are performed and reviewed for all open bank accounts. The grantee did not have signatures/dates on six of the ten reconciliation summaries sampled to show review and approval of the bank reconciliations.

Section 3-5.2(d) of the LSC *Fundamental Criteria* notes reconciliations shall be reviewed and approved by a responsible individual. Such review shall be appropriately documented by signature and date.

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, especially in an environment where full segregation of duties is not practicable.

Outstanding Checks

Per the grantee’s Accounting Manual, any outstanding checks over six months old are reviewed for disposition, including write-off by journal entry. During our review of the bank reconciliations, we noted several checks outstanding greater than six months.

The lack of monitoring checks outstanding for more than six months could result in the possibility of undetected fraudulent signatures or endorsements, alterations of checks, improper use of voided checks, or improper recording of bank transfers.

Cash Receipts Accountability

During our test work we noted cash receipts are not accounted for immediately upon receipt. We also noted the checks are endorsed by the same person that has access to the accounting systems. The cash receipts are reviewed by the Executive Director and then given to the Intake Specialist to record the information in the cash receipts log. The Director of Finance and Administration endorses and records the cash receipt.

Section 3-5.4 of LSC's *Fundamental Criteria* notes initial accountability for cash should be established as soon as a cash item is received. This responsibility should be assigned to a person with no other bookkeeping duties. Accountability should begin with the individual opening the mail. Section 3-4 of LSC's Accounting Guide states accounting duties should be segregated to ensure that no individual simultaneously has both the physical control and the record keeping responsibility 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.

According to the Director of Finance and Administration, the Intake Specialist is not opening all of the mail so the Executive Director opens cash receipts first. The Director of Finance and Administration further stated they were trying to have a separation of duties and are looking to hire another accountant to assist.

Lack of control over cash means that it may go unrecorded or not deposited. Checks that are endorsed with no restriction can be cashed by unauthorized individuals.

Recommendations: The Interim Executive Director should ensure:

Recommendation 20: that bank reconciliations are reviewed and documented by both signature and date.

Recommendation 21: to follow up on checks which have been outstanding for more than six months as required by the grantee's written policies.

Recommendation 22: the individual opening the mail, preferably an individual with no other bookkeeping duties, immediately records and endorses cash items.

SUMMARY OF GRANTEE MANAGEMENT COMMENTS

Grantee management agreed with the findings and recommendations contained in the report but was not responsive to two recommendations. Grantee management stated the following:

- They have taken into consideration all our recommendations provided in the audit report and updated their Accounting/Finance Policies and Procedures Manual to reflect the recommendations;
- They reorganized their QuickBooks's chart of accounts to include funding sources;
- They contracted with a new payroll company that will allow them to allocate staff time electronically;
- They put into place a new contracting system that requires documentation to be provided to the Director of Finance and Administration and kept on file in a central location;
- They updated their disbursement process by creating a Check Request Form and Request for Payment Form;
- Invoices are stamped to doubly ensure they will only be entered once;
- They have implemented a process that requires staff seeking to use the debit card to complete a Debit Card Authorization Form and receive approval prior to use;
- They implemented a new timesheet submission process that requires managers to review timesheets for accuracy and complete a Management Approval Form each pay period;
- They will start using a new payroll company in April that will give NLSP employees the ability to electronically approve timesheets and to submit requests for leave;
- They have designated a staff person with the physical inventory responsibilities and will work with their auditors to reconcile inventory to the depreciation schedule;
- They have segregated duties for check deposits;
- They have contracted with an outside accountant to perform bank reconciliations; and
- They implemented a process to monitor outstanding checks and void checks six months after the issue date.

The Grantee's comments are included in Appendix II.

OIG EVALUATION OF GRANTEE MANAGEMENT COMMENTS

The OIG considers the proposed actions to Recommendations 1, 2, 3, 5, 6, 7, 8, 9, 10, 11, 13, 14, 15, 16, 17, 18, 19, 20, 21, and 22 as responsive. The actions planned and implemented by grantee management to address the issues and revise and update its Accounting/Finance Policies and Procedures Manual should correct the issues identified in the report.

Recommendation 1 will remain open until the grantee's Accounting/Finance Policies and Procedures Manual has obtained the required Board of Directors' approval.

Recommendation 2, concerning the accounting system, will remain open as management did not provide the new QuickBooks chart of accounts that provides support of the funding sources being added into the accounting system.

Recommendation 16, regarding subsidiary property records, will remain open as management did not provide a sample of the new property records that includes all the required elements.

Recommendation 17, regarding the physical inventory reconciliation, will remain open as management has not reconciled the accounting property records with the physical inventory.

Recommendation 18 on tracking IT equipment, remains open as the grantee did not address how they would track IT equipment, such as laptops.

The grantee was not responsive to Recommendations 4 and 12. These recommendations are related to cost allocation and the debit card. The grantee did not address what supporting documentation will be used and maintained to provide an audit trail of the cost allocation made to funding sources. The grantee also did not address the concern of the debit card remaining in the name of the prior Executive Director. Consequently, these recommendations will remain open. The OIG is referring these recommendations to LSC management for resolution.

Recommendations 3, 5, 6, 7, 8, 9,10, 11, 13, 14, 15, 19, 20, 21, and 22 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 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 for the most part was sufficiently reliable for the purposes of this report.

To test for the appropriateness of expenditures and the existence of adequate supporting documentation, disbursements from a haphazardly selected sample of vendor files were reviewed. The sample consisted of 70 disbursements totaling $110,805.31. The sample represented approximately 10.2 percent of the $1,083,268.43 disbursed for expenses other than payroll during the period January 1, 2015 to August 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.

Included in the disbursement sample were twelve debit card transactions totaling $7,539.60. 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 cost allocation 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 NLSP 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 31, 2016 through November 4, 2016. Our work was conducted at the grantee's central administrative office and at LSC headquarters, both in Washington, DC. Documents reviewed pertained to the period January 1, 2015 through August 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.

NEIGHBORHOOD LEGAL SERVICES PROGRAM
680 Rhode Island Avenue NE, Washington, DC 20002 | 202.832.6577 | www.nlsp.org

March 20, 2017

Mr. John M. Seeba
Assistant Inspector General for Audit
Legal Services Corporation
3333 K Street, NW, 3rd Floor
Washington, DC 20007

Dear Mr. Seeba:

I am pleased to provide this letter and the enclosed documents in response to your letter and report dated February 23, 2017. As noted in your report, Director of Finance and Administration Kathy Hollins and I started employment with Neighborhood Legal Services in August and September of 2016. We made several improvements to tighthen our financial operations prior to the audit. The team's process and report gave us further work to do, and also confirmed that our improvements were on track.

Ms. Hollins and I have both prioritized putting systems and procedures in place to ensure that Neighborhood Legal Services Program is operating in compliance with all LSC requirements. We have taken into consideration all of the recommendations provided in your audit report and updated our Accounting Policies Manual to reflect these recommendations. I also want to address specific items noted in your report.

Cost Allocations

Prior to August 2016 cost allocations were managed with Excel spreadsheets. These spreadsheets were provided to the audit team and the CPA who had created them was available to answer any questions regarding the methodology used.

Each staff member who was covered by a grant had their time allocated to that funding source and all allowable expenses in the grant budget were charged to the appropriate funding source.

The NLSP accounting system was not set up to enter financial data by funding source.

680 Rhode Island Avenue NE, Washington, DC 20002 | 202.832.6577 | www.nlsp.org

Corrective Action
NLSP management has worked with an outside accountant to reorganize our QuickBooks's chart of accounts. We have created a system that requires bills to be coded by funding source and approved by the appropriate person prior to being entered into the bill paying system. This will ensure that direct costs are allocated timely and not after the fact.

Staff will record their time per funding source on their bi-weekly time sheets, which will feed directly into the accounting system. To expedite this process, we have contracted with a new payroll company that will allow us to allocate staff time electronically.

Direct costs will be coded to specific funding sources. Indirect costs will be spread across funding sources, as allowed by the grantor, according to the percentage of staff FTEs on the grant relative to the total staff FTEs. Indirect costs beyond those allowed by the grant will be allocated to funding sources that allow such.

The new chart of accounts and timekeeping system allows NSLP to allocate and report in a more timely and accurate way to specific funding sources and constitutes a significant improvement in the NLSP accounting system.

Contracting
The documentation for several of NLSP's contracts was unable to be located in a timely fashion, and the report also notes that 3 of the 10 vendor files sampled did not follow NLSP's policy requiring Board approval for contracts over $10,000.

The accounting manual in effect at the time of the audit did not provide guidance on how various types of contracts should be handled.

There was no consistency in how contracts were being handled prior to 2016. Management was able to locate several pieces of supporting documentation after searching in several places.

Corrective Action
NLSP has updated the accounting manual to include direction on multi-year and one-time contracts requiring board approval. The manual now also addresses when competitive bids need to be requested, and when they are not required.

680 Rhode Island Avenue NE, Washington, DC 20002 | 202.832.6577 | www.nlsp.org

NLSP now has a system in place that requires documentation including requests for proposals, responses from vendors, the selection method used and the contract to be provided to the Director of Finance and Administration and kept on file in a central location.

NLSP's accounting manual now details what information must be contained in all contracts.

Disbursements
It was determined that some of the items sampled, while allowable, lacked proper supporting documentation or lacked adequate approval.

The majority of the approval process was occurring electronically prior to August 2016. Those approval emails were not being printed out and attached to purchase receipts.

Corrective Action
NLSP has a new documented disbursements process that we have been following since September 2016.

All requests for payment are submitted to the Director of Finance and Administration on a Check Request Form or a Request for Payment Form. Vendor invoices and check requests are entered into the accounting system and an A/P Aging Summary is generated from the accounting system.

The Aging Summary and all of the invoices are provided to the Executive Director for review and approval. The Executive Director signs and dates each invoice as well as the Aging Summary and returns the batch to the Director of Finance and Administration to prepare checks.

The prepared checks and invoices are once again returned to the Executive Director for final review and signing.

The signed checks are returned to the Director of Finance and Administration for mailing and filing.

In order to avoid the risk of duplicate payments, the Director of Finance and Administration, enters all invoice numbers into the accounting system which will

680 Rhode Island Avenue NE, Washington, DC 20002 | 202.832.6577 | www.nlsp.org

notify her if that number has been previously entered for a vendor. She stamps each invoice as entered to doubly ensure that it will only be entered once.

Check stubs are attached to the invoices prior to filing.

Debit Cards
NLSP has one debit card that is currently in the possession of the Director of Finance and Administration under lock and key. Prior to August 2016 the debit card was in the possession of the Executive Director who provided verbal or written approval to employees needing to make a debit card purchase.

Corrective Action
Since September 2016, we have implemented a process that requires any staff seeking to use the debit card to complete a Debit Card Authorization Form and receive approval prior to use. The new form requires the following information:

Date
Vendor
Funding code
Reason for purchase
Approval signature and date

There is no need to limit the number of users or set a maximum spending amount since prior approval is required before a staff member takes possession of the card.

Payroll
It is stated in the audit report that timesheets and leave requests were processed without management approval being documented. Prior to October 2016, timesheets were emailed to the employee's supervisor and the Director of Finance and Administration, the supervisor would then send a reply to the employee and the Director of Finance and Administration stating that the timesheet was approved.

This was not an efficient way to process timesheet approvals.

Corrective Action
In October 2016, NLSP implemented a new timesheet submission process. This process requires managers to review timesheets for accuracy and to complete a Management Approval Form each pay period that lists each employees' hours and to sign and date the form.

NEIGHBORHOOD LEGAL SERVICES PROGRAM
680 Rhode Island Avenue NE, Washington, DC 20002 | 202.832.6577 | www.nlsp.org

Leave request forms are required to be completed and approved before being handed in to the Director of Finance and Administration.

The new payroll company we will use starting in April will give NLSP employees the ability to electronically approve timesheets and to submit requests for leave.

Fixed Assets
NLSP's internal controls over fixed assets were lax. We had not performed a physical inventory since 2014, and the physical inventory had not been reconciled with the depreciation schedule.

Corrective Action
While we cannot speak to how or why these items were not carried out prior to August 2016 ,we have taken action based upon the audit team's recommendations. We have given the Compliance and Operations Coordinator the responsibility of performing a physical inventory, locating any equipment that is not accounted for. We have also created a method that will allow us to make items such as laptops to be secured yet accessible to staff when needed. We will work with our auditor to reconcile our inventory to the depreciation schedule on an on-going basis going forward.

Segregation of Duties
The audit report states that NLSP needed to create and implement practices that segregate duties in regards to depositing checks. NLSP has a small administrative staff with limited options when it comes to assigning financial tasks. The Director of Finance and Administration utilizes a remote deposit machine which is not practical to place at the front desk.

Corrective Action
When checks are received in the mail, the Intake Specialist at the front desk is responsible for logging the check into a log book and endorsing the check prior to the check being given to the Director of Finance and Administration to electronically deposit. We will continue to look for ways in which we can segregate check deposit duties in the future.

680 Rhode Island Avenue NE, Washington, DC 20002 | 202.832.6577 | www.nlsp.org

General Ledger and Financial Controls
Bank reconciliations from October 2015 and from June 2016 did not have signatures and dates showing that they had been reviewed and approved by the Executive Director.

Corrective Action
Bank reconciliations from September 2016 forward have been submitted to the Executive Director for review and approval. As of January 2017, we have contracted with an outside accountant who is now performing bank reconciliations, creating an additional layer of segregation of duties.

Outstanding checks will be monitored and voided six months after the issue date as per NLSP's Accounting Policies and Procedures Manual.

Again, our thanks to the audit team for their diligence and patience. Please let me know if I can answer any questions or provide additional information.

Sincerely,

Barbara Laur
Interim Executive Director

Attachments:
Debit Card Authorization Form
Check Request Form
Request for Payment
Management Approval Form (Timesheets)
NLSP Accounting Policies and Procedures Manual