



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

July 11, 2017

Ms. Catherine Clayton
Executive Director
West Tennessee Legal Services
210 W. Main Street
P.O Box 2066
Jackson, TN 38302-2066

Dear Ms. Clayton:

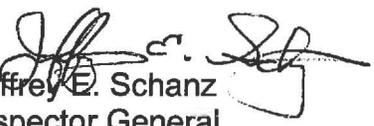
Enclosed is the Legal Services Corporation's (LSC) Office of Inspector General's (OIG) final report for our audit on Selected Internal Controls at West Tennessee Legal Services. As suggested in your response, we have made corrections to the Background section on page 1 of the draft report. Your comments are included in the final report as Appendix II.

The OIG considers the proposed actions to Recommendations 1, 2, 3, 4, and 5 as responsive. The actions planned by the grantee management to address the issues and revise its Accounting Manual should correct the issues identified in the report. However, these recommendations will remain open until the Board of Directors have adopted the policies and the revised manual is provided to the OIG.

The OIG accepts the stated actions for Recommendations 6 and 7 and they are considered closed.

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

Sincerely,


Jeffrey E. Schanz
Inspector General

Enclosure

cc: Legal Services Corporation
Jim Sandman, President

Lynn Jennings,
Vice President, for Grants Management

West Tennessee Legal Services, Inc.
Larry Barbee
Board Chairperson

Sent by E-mail to Board of Directors
Charles H. Barnett
John Hamilton
William F. Kendall
Kortney Simmons
Vanedda Webb
Laura A. Keeton
Mary Jo Middlebrooks
Barbara R. Hudson

**LEGAL SERVICES CORPORATION
OFFICE OF INSPECTOR GENERAL**

**FINAL REPORT ON SELECTED INTERNAL
CONTROLS**

WEST TENNESSEE LEGAL SERVICES INC.

RNO 643061

Report No. AU 17-07

July 2017

www.oig.lsc.gov

Table of Contents

INTRODUCTION	1
BACKGROUND	1
OBJECTIVE	2
AUDIT FINDING	2
WRITTEN POLICIES AND PROCEDURES	2
Recommendation 1	5
Recommendation 2	5
Recommendation 3	5
Recommendation 4	5
DISBURSEMENTS	5
Recommendation 5	6
Recommendation 6	6
CONTRACTING	6
Recommendation 7	7
SUMMARY OF GRANTEE MANAGEMENT COMMENTS	8
OIG EVALUATION OF GRANTEE MANAGEMENT COMMENTS	8
APPENDIX I – SCOPE AND METHODOLOGY	9
APPENDIX II – GRANTEE MANAGEMENT COMMENTS	11

INTRODUCTION

The Legal Services Corporation (LSC) Office of Inspector General (OIG) assessed the adequacy of selected internal controls in place at West Tennessee Legal Services, Inc. (WTLS or grantee), related to specific operations and oversight. Audit work was conducted at the grantee's administrative office in Jackson, Tennessee and at LSC headquarters in Washington, DC.

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

[T]he process put in place, managed and maintained by the recipient's board of directors and management, which is designed to provide reasonable assurance of achieving the following objectives:

1. safeguarding of assets against unauthorized use or disposition;
2. reliability of financial information and reporting; and
3. compliance with regulations and laws that have a direct and material effect on the program.

Chapter 3 of the Accounting Guide further provides that each grantee "must rely upon its own system of internal accounting controls and procedures to address these concerns" such as preventing defalcations and meeting the complete financial information needs of its management.

BACKGROUND

WTLS is a non-profit law firm that, for 36 years, has provided free legal assistance to individuals residing in 17 West Tennessee counties. This assistance includes non-criminal proceedings and matters to persons financially unable to afford legal assistance. WTLS receives funding from grants through private foundations, government contracts, and individual donations.

Audited financial statements for fiscal year ending 2015 showed that the grantee received total funding in the amount of \$3,640,307 from grants and contracts. LSC provided \$693,812 or 19 percent of the grantee's funding, and the remaining 81 percent was from non-LSC sources.

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 FINDING

To accomplish the audit objective, the OIG reviewed and tested internal controls related to cash lines of credit, cost allocation, contracting, property and equipment, derivative income, employee benefits, 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, we found that controls in the areas detailed below need to be strengthened and/or formalized in writing.

WRITTEN POLICIES AND PROCEDURES

The grantee's Accounting Manual had adequate written policies and procedures in place in the areas of contracting, derivative income and employee benefits. However, there were no written policies and procedures for management reporting and budgeting and lines of credit. In addition, we found that policies in the areas of property and equipment, cost allocation and disbursements need to be enhanced to include practices in place, so that the written policies and procedures properly describe the controls actually followed by the grantee.

Property and Equipment - Vehicles

The grantee's internal controls over the two vehicles owned were not detailed in writing. The grantee purchased the two vehicles with LSC funds in 2004 and 2007, costing \$19,504 and \$20,121, respectively. Our test work revealed the grantee's practices in place were comparable to the *Fundamental Criteria of an Accounting and Financial Reporting System (Fundamental Criteria)* contained in the LSC Accounting Guide. The practices include monitoring and tracking employees' operation of the grantee's vehicles using a shared calendar and mileage logs. In addition, the grantee also reviews and reconciles mileage logs, safeguards the vehicles' keys, and tracks the use of gas cards. Nevertheless, these practices were not detailed in writing.

Written policies and procedures serve as a method to document the design of controls and to clearly communicate the controls so that both employees and supervisors understand the terms by which these vehicles may be used.

Disbursements and Cost Allocation

The grantee's disbursements and cost allocation written policies and procedures do not describe how any LSC unallowable expenses are allocated. Grantee management stated they are cognizant of LSC regulations and that LSC unallowable costs are charged to an unrestricted fund. Our test work revealed the grantee's allocation methodology is adequate and in conformity with LSC's *Fundamental Criteria*. However, without a written procedure for allocating LSC unallowable costs, there is an increased risk of LSC funds being used for unallowable expenses.

Management Reporting and Budgeting

The grantee has no written policies and procedure over its management reporting and budgeting processes. Our test work revealed the grantee has adequate reporting and budgeting processes in place that are comparable to LSC's *Fundamental Criteria*. The Executive Director is provided monthly reports with useful information to show funds are being spent appropriately and allocations are correct. The reports also serve as a tool to evaluate progress and to determine whether there are adequate funds. These reports are presented to the Finance Committee and Board of Directors at each respective board and /or committee meeting. In addition, the Executive Director, Business Manager and Financial Assistant are all involved in the budgeting process. The budget is presented to the Finance Committee and Board of Directors for approval. However, these processes in place are not formalized in writing.

Written policies and procedures serve as a method to document the design of controls and communicate the controls to the staff. Without policies and procedures, a risk of untimely management reports may result in erroneous decision-making on the part of management and the board.

Lines of Credit

The grantee has no written policies and procedures over its line of credit accounts. The grantee has line of credit accounts with Dell, Walmart, Lowes, Sam's Club and Office Depot. These accounts are for small purchases of IT equipment and office and maintenance supplies. In addition, there is also an account with Exxon for fuel. There are store cards associated with these accounts for point of sale transactions except for the Dell account.

Although our test work revealed that all seven of the seven statements sampled were adequately supported, properly approved, and had no charges of LSC unallowable expenses, we found that the account and card number information needs to be more

secured, especially when a card has more than one authorized user. Below is a summary of the line of credit limits for each account and user information:

Line of Credit Account	Credit Limit	Number of Authorized User	Issued with Card
Dell	\$50,000	One	No
Walmart	\$6,000	All employees	Yes
Lowes	\$8,750	Three	Yes
Sam's Club	\$7,500	Two	Yes
Office Depot	\$5,000	Three	Yes
Exxon	\$720	All employees	Yes

As detailed above, both the Walmart and Exxon accounts have all grantee employees as authorized users. And with no written policies and procedures in place, the grantee does not limit the number of authorized users specific to and compatible with the individual employee responsibilities.

The Financial Assistant stated that the purchasing procedures in the Accounting Manual are followed. The grantee's purchasing procedures states that a purchase request is required before any purchases can be made. Also, purchases amounting to \$5,000 and over require an approval from the Executive Director. In addition, the Office Depot and Walmart cards must be checked out from the Financial Assistant for a specific purchase and gas receipts are compared to the statements to verify the date and time the vehicle was used, as well as fuel costs. However, the purchasing procedures do not include policies and procedures specific to checking out and using the credit cards. Without a written policy and procedure, the store cards may be subject to unauthorized transactions resulting in fraud or abuse.

Per grantee management, the practices in place are not detailed in their Accounting Manual and the lack of written policies and procedures was due to an oversight.

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

Section 3-5.9 of LSC Accounting Guide states that policies, procedures, and responsibilities for all report preparation should be determined and documented in an Accounting Manual. The Executive Director should receive a monthly management report within a prescribed number of days after month-end.

Recommendations: The Executive Director should:

Recommendation 1: enhance written policies and procedures related to the use of the grantee owned vehicles to include current practices in place.

Recommendation 2: document policies and procedures that describe how LSC unallowable expenses are to be recorded.

Recommendation 3: develop written policies and procedures describing the process governing the preparation, content and use of management reports and budgets.

Recommendation 4: develop a written policy specific to line of credit accounts. The policy should include the following:

- Procedures to ensure that only a limited number of authorized individuals can purchase goods and services.
- Procedures stating that any personal and/or disallowed charges may be deducted from the employee's paycheck.

DISBURSEMENTS

Lack of Segregation of Duties

There is lack of segregation of duties over the master vendor list. The Financial Assistant is responsible for accounts payable duties that include initiating and processing payments and maintaining the master vendor list. In addition, both the Business Manager and the Financial Assistant can add new vendors and make necessary changes to the vendor information. The Business Manager explained that she reviews all the accounts payable transactions prior to payment and only serves as a back-up in maintaining the master vendor list. However, a lack of segregation of duties over the master vendor list may result in unauthorized or fraudulent payments to vendors.

Section 3-4 of LSC Accounting Guide states that accounting duties should be segregated to ensure that no individual simultaneously has both physical control and 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.

No Prior Approval for Out of State Travel

Seven out of nine disbursements related to out of state travel, totaling \$8,792.18, had no documentation of requests for prior approval from the Executive Director. The Financial Assistant explained there were no prior travel requests approved by the Executive Director because the out of state travels were for a required training and/or conferences which are considered an exception from their policy. However, lack of advance

authorization for expenditures could subject management to higher than anticipated costs.

Section 3-5.4 of LSC Accounting Guide states that approval should be required at an appropriate level of management before a commitment of resources is made. Also, travel procedures written in the WTLS Accounting Manual states that out of state travel for which the traveler intends to claim per diem, require prior approval of the Executive Director.

Recommendations: The Executive Director should:

Recommendation 5: establish and adhere to written policies for securing and approving new vendors to ensure segregation of duties. These policies should outline setting up new vendors in the accounting system to ensure that only employees independent of the accounts payable function can create new vendors and/or include a review and approval process by appropriate management such as the Executive Director.

Recommendation 6: ensure that WTLS staff abides by its own travel policy, e.g., WTLS staff traveling out of state should request prior approval from the Executive Director and the approval should be documented.

CONTRACTING

Inadequate Documentation

There was no documentation of approvals for two of four contracts and agreements reviewed. Four contract files were reviewed to determine whether the grantee has adequate internal controls over the contracting process. We found the following:

- Two contracts for service and maintenance had documentation of the contract and bids, however, there was no documentation of approvals.
- One agreement was made with a former Controller employee to assist in closing accounting books and train the new Business Manager; however, the agreement was not documented in writing.

The Executive Director has only been with WTLS since October 2015 and was not able to provide information for the missing approval documentation because the contracts were established prior to her tenure at WTLS. The Executive Director explained that she entered into a verbal agreement with the former Controller because they do not anticipate a prolonged need for her services. However, contracting is a high-risk area for potential abuse. A detailed description of services prevents misunderstanding about costs, deliverables, or the time in which a task is to be completed. Also, if not properly conducted, weak contracting practices can result in a waste of scarce funds.

The grantee's Accounting Manual states that the Controller will maintain and retain all relevant documents in the accounting department in accordance with WTLS document retention policies.

In addition, Section 3-5.16 of the LSC Accounting Guide states that the process used for each contract action, including any deviation from the approved contracting process, should be fully documented with the documentation maintained in a central file.

Recommendation 7: The Executive Director should ensure that the process used for each contract action, including approvals and deviations from approval, is fully documented and maintained in a central file.

SUMMARY OF GRANTEE MANAGEMENT COMMENTS

Grantee management agreed with all the findings and recommendations contained in the report. Grantee management stated the following actions were taken or are in progress as draft policies, pending adoption by WTLS' Board of Directors:

- Enhanced its written policies and procedures in the Accounting Manual with respect to the use of grantee owned vehicles to include current practices in place.
- Added a provision to its Accounting Manual under new Section, "Unallowable Expenses", that confirms in writing WTLS' longstanding policy for recording LSC unallowable expenses, specifically that expenses unallowable under LSC policy are paid by unrestricted funds.
- Added a new section to the Accounting Manual titled "Preparation, Content, and Use of Management Reports and Budgets."
- Added a "Line of Credit Policy" to the Accounting Manual that includes OIG's recommended procedures stating that any personal and/or disallowed charges may be deducted from the employee's paycheck. All employees having access to WTLS Line of Credit will be required to sign an acknowledgement that they understand and agree with this policy, which will be placed in their personnel files.
- Changed its written policy so that the Senior Financial Assistant can no longer set up new vendors in the accounting system. The setting up of new vendors in the accounting system shall be done by the Business Manager.
- Enforced its existing travel policy wherein WTLS staff are required to request prior approval for out of state travel in writing from the Executive Director, whose approval shall also be documented in writing.
- The Executive Director has taken appropriate steps to ensure that the process used for each contract action is fully documented and maintained in a central file.

OIG EVALUATION OF GRANTEE MANAGEMENT COMMENTS

The OIG considers the proposed actions to Recommendations 1 through 5 as responsive. The actions planned by the grantee management to address the issues and revise its Accounting Manual should correct the issues identified in the report. However, these recommendations will remain open until the Board of Director's have adopted the policies and the revised manual is provided to the OIG.

The OIG accepts the stated actions for Recommendations 6 and 7 and they are 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,
- Line of Credit Accounts,
- Contracting,
- Cost Allocation,
- Derivative Income,
- General Ledger and Financial Controls,
- Internal Management Reporting and Budgeting,
- Property and Equipment, and
- Employee Benefits.

To obtain an understanding of 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 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 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 judgmentally selected sample of vendor files were reviewed. The sample consisted of 85 disbursements totaling \$187,661.76. The sample represented approximately 8.55 percent of the \$2,195,505.11 disbursed for expenses other than payroll during the period January 1, 2016 to January 31, 2017. To assess the

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

Included in the disbursement sample were statements from line of credit accounts totaling \$8,044.73. 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, 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 WTLS allocation process and if the transactions were properly allocated in the accounting system.

Controls over purchasing, recording, inventory and disposal 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 February 27, 2017 through March 3, 2017. Our work was conducted at the grantee's central administrative office in Jackson, TN and at LSC headquarters in Washington, DC. Documents reviewed pertained to the period January 1, 2016 through January 31, 2017.

This audit was conducted in accordance with Generally Accepted Government Audit 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 audit objectives.

June 26, 2017

Mr. John Seeba
Assistant Inspector General for Audit
Office of the Inspector General
Legal Services Corporation
3333 K Street, NW, 3rd Floor
Washington, D.C. 20007-3558
Sent via mail and faxed to 202.337.6616

Re: West Tennessee Legal Services, Inc., RNO 122150

Dear Mr. Seeba,

Below are West Tennessee Legal Services' (WTLS') responses to the Office of Inspector General (OIG) Draft Report on Selected Internal Controls, Report No. AU 17-XX, which was sent to me on May 24, 2017, for the on-site audit visit conducted February 27 – March 3, 2017. The OIG team, led by Meliza Ella, Senior Auditor, was unfailingly courteous and very thorough. We found their comments during the actual review, as well as those contained in the draft report, constructive. As reflected in the comments below, WTLS has implemented responsive policy to the seven (7) recommended actions. These policies have been presented to and approved by WTLS' Finance Committee, which met this morning. The draft policies will be presented to the full WTLS Board at our July 2017 Board meeting. Upon adoption by the full Board, WTLS' Accounting Manual will be amended.

There is one correction to the Background section on page 1 of the draft report that I ask be made. The first sentence of that section states that WTLS has provided free legal assistance in our 17- county service area for twenty (20) years. WTLS opened our doors on January 1, 1979, initially providing free legal assistance to five (5) counties in our service area. Thanks to the Expansion Grant of 1981, WTLS has, for the last thirty-six (36) years provided free civil legal assistance to our low income neighbors in our 17-county service area.

I. WRITTEN POLICIES AND PROCEDURES

Recommendation 1: The Executive Director should enhance written policies and procedures with respect to the use of the grantee owned vehicles to include current practices in place.

Response: WTLS agrees with this recommendation. WTLS has enhanced its written policies and procedures in its Accounting Manual with respect to the use of grantee owned vehicles to include current practices in place. This enhanced written policy and procedure has been approved by WTLS' Finance Committee for inclusion in the Accounting Manual. These changes have been circulated to all staff.

APPENDIX II

Recommendation 2: The Executive Director should document policies and procedures that describe how LSC unallowable expenses are to be recorded.

Response: WTLS agrees with this recommendation and has added a provision to its Accounting Manual under new Section, "Unallowable Expenses", that confirms in writing WTLS' longstanding policy for recording LSC unallowable expenses, specifically that expenses unallowable under LSC policy are paid by unrestricted funds.

Recommendation 3: The Executive Director should develop written policies and procedures describing the process governing the preparation, content, and use of management reports and budgets.

Response: WTLS agrees with this recommendation and has added a new section to our Accounting Manual titled "Preparation, Content, and Use of Management Reports and Budgets", which has been reviewed and approved by the Finance Committee. This section incorporates the Fundamental Criteria set for in the LSC Accounting Manual, §3-5.9 (Management Reports) and §3-5.10 (Budgeting).

Recommendation 4: The Executive Director should develop a written policy specific to line of credit accounts. The policy should include the following:

- Procedures to ensure that only a limited number of authorized individuals can purchase goods and services
- Procedures stating that any personal and/or disallowed charges may be deducted from the employee's paycheck.

Response: WTLS agrees that we should have a written policy specific to our line of credit accounts. A written "Line of Credit Policy" has been approved by the Finance Committee and added to WTLS' Accounting Manual that includes OIG's recommended procedures stating that any personal and/or disallowed charges may be deducted from the employee's paycheck. Additionally, all employees having access to WTLS Lines of Credit will be required to sign an acknowledgement that they understand and agree with this policy, which will be placed in their personnel files. WTLS' Line of Credit Policy provides adequate safeguards for all employees to be authorized to use the gas cards, which are used only to refill the company cars, and Walmart cards in accordance with written procedures and safeguards, as authorized use of those cards by all employees is necessary for WTLS' business.

II. DISBURSEMENTS

Recommendation 5: The Executive Director should establish and adhere to written policies for securing and approving new vendors to ensure segregation of duties. These policies should outline setting up new vendors in the accounting system to ensure that only employees independent of the accounts payable function can create new vendors

Response: WTLS agrees with this recommendation and has changed its written policy so that the

APPENDIX II

senior financial assistant can no longer set up new vendors in the accounting system. The setting up of new vendors in the accounting system shall be done by the Business Manager.

Recommendation 6: The Executive Director should ensure that WTLS staff abides by its own travel policy, e.g., WTLS staff traveling out of state should request prior approval from the Executive Director and the approval should be documented.

Response: WTLS agrees with this recommendation. WTLS has, since this issue was brought up by the OIG auditors during their visit, enforced its existing travel policy wherein WTLS staff are required to request prior approval for out of state travel in writing from the Executive Director, whose approval shall also be documented in writing. The form for requesting prior approval is available on WTLS' internal employee website. A memo has been sent to all employees reminding them of this policy and advising that it will be enforced.

III. CONTRACTING

Recommendation 7: The Executive Director should ensure that the process used for each contract action, including approvals and deviations from approval, is fully documented and maintained in a central file.

Response: WTLS agrees with this recommendation. WTLS's Executive Director has taken appropriate steps to ensure that the process used for each contract action is fully documented and maintained in a central file. These steps include meeting with accounting staff about the importance of maintaining a central file on all contracts, including approvals and deviations from approval, and strengthening existing policy the Accounting Manual. The prior policy contained in the Accounting manual has been strengthened in accordance with this recommendation.

Please let me know if you need further information from me. Thank you and the OIG team that conducted our on-site visit for the helpful review of our internal controls.

Best regards,



Catherine Clayton
Executive Director, West Tennessee Legal Services