Office of Inspector General
Legal Services Corporation

Inspector General
Jeffrey E. Schanz

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August 11, 2011

Ms. Rhodia Thomas
Executive Director
MidPenn Legal Services
213-A North Front Street
Harrisburg, PA 17104

Dear Ms. Thomas:

Enclosed is the Office of Inspector General's final report on the results of our audit on Selected Controls at MidPenn Legal Services. We have reviewed your response to the recommendations in the draft report and believe your proposed actions adequately address the issues. Recommendations 2, 3 and 4 are closed because corrective actions have already been taken. Recommendation 1 is open until all stated management actions are taken and the OIG is notified of such in writing.

Thank you and your staff for your courtesy and cooperation during this audit.

Sincerely,

Jeffrey E. Schanz
Inspector General

Enclosure

cc: James Sandman, President
Legal Services Corporation

LSC
America's Partner For Equal Justice

LEGAL SERVICES CORPORATION
OFFICE OF INSPECTOR GENERAL

REPORT ON SELECTED INTERNAL CONTROLS

MIDPENN LEGAL SERVICES, INC

RNO 339040

Report No. AU-11-04

August 2011

www.oig.lsc.gov

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INTRODUCTION

The Legal Services Corporation (LSC) Office of Inspector General (OIG) assessed the adequacy of selected internal controls in place at MidPenn Legal Services, Inc. (grantee or MPLS) related to grantee operations and oversight. Audit work was conducted at the grantee's main office in Harrisburg, PA and at LSC headquarters in Washington, DC. The on-site fieldwork was conducted on May 3 through 11 and August 30 through 31, 2010. Documents reviewed pertained to the period January 1, 2009 through March 31, 2010.

In accordance with the Legal Services Corporation Accounting Guide for LSC Recipients (2010 Edition) [1] (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:
>
> - safeguarding of assets against unauthorized use or disposition;
> - reliability of financial information and reporting; and
> - 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 concerns" such as preventing defalcations and meeting the complete financial information needs of its management.

OBJECTIVE

The overall audit objective was to assess the adequacy of selected internal controls in place at MidPenn Legal Services, Inc. as the controls related to operations and oversight, including program expenditures, fiscal accountability, and compliance with selected LSC regulations. 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. In addition, the Office of Inspector General examined regulatory policies and grantee processes to assess whether controls were designed in a manner expected to ensure compliance with the LSC Act and the reviewed LSC

[1] The Accounting Guide (1997 Edition) was used to evaluate all documentation and transactions reviewed for this audit. During the course of the audit, LSC issued a revised Accounting Guide (the 2010 Edition). For all references to the Accounting Guide (1997 Edition) contained in this report, the same requirements and information are contained in the Accounting Guide (2010 Edition).

regulations. However, reaching conclusions regarding compliance with any specific regulation was not an objective of the audit.

SCOPE AND METHODOLOGY

To accomplish the objective, controls over disbursements, internal management reporting and budgeting, selected LSC regulations, and employee benefits and reimbursements were reviewed. To obtain an understanding of the internal controls over these areas, policies and procedures were reviewed, including manuals, guidelines, memoranda, and directives setting forth current practices. MPLS 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. Computer-generated data provided by the grantee was relied on to determine whether entries recorded in computer systems matched the information contained on the source documents. However, the OIG did not test the general or application controls over the computer system because it was not necessary to evaluate the information system controls to answer the audit objectives.

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 171 transactions totaling $94,037 of the over $9 million disbursed during the period January 1, 2009 through March 31, 2010. To assess the appropriateness of these expenditures, we reviewed invoices, vendor lists, and general ledger details. The appropriateness of grantee expenditures was evaluated on the basis of the grant agreements, applicable laws and regulations, and LSC policy guidance.

To review internal controls over internal management reporting and budgeting, the grantee's system and processes were tested and compared to those detailed in the *Fundamental Criteria of an Accounting and Financial Reporting System* (*Fundamental Criteria*) contained in the Accounting Guide. Controls over employee benefits and reimbursements were reviewed by examining the collective bargaining agreement and other personnel policies and practices, and by testing a judgmentally selected sample of 26 employee reimbursements as part of the disbursements testing.

To review internal controls over compliance with specific LSC regulations (45 CFR Parts 1610, 1612 and 1617), written compliance policies and procedures were examined, including those based on applicable LSC mandated recordkeeping requirements; applicable documentation and reports were reviewed; and staff members were interviewed. This allowed the OIG to determine if the controls were designed in a manner to ensure compliance with the provisions of the respective LSC regulation.

This review was limited in scope and not sufficient for expressing an opinion on the entire system of grantee internal controls over financial operations or compliance with LSC regulations.

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.

OVERALL EVALUATION

Internal controls reviewed at MPLS were adequate as the controls related to specific grantee operations and oversight, including program expenditures, fiscal accountability, and compliance with LSC regulations. However, some controls need to be strengthened or formalized. Controls over regulations were designed in a manner expected to ensure compliance with the LSC Act and selected LSC regulations.

Grantee disbursements tested were adequately supported, allowable, and properly allocated to LSC funds. The grantee's current practices involving internal management reporting and budgeting were generally in accordance with the *Fundamental Criteria* contained in the Accounting Guide. Internal controls over reimbursements and employee benefits were adequate. Policies over employee benefits practices were in writing and followed.

The following areas were noted where internal controls could be strengthened:

- Preparing property subsidiary records for all applicable property items,
- Properly recording and reporting derivative income,
- Completing and implementing an entity-wide disaster recovery plan, and
- Marking invoices and other related documentation as paid to prevent duplicate payments.

Internal controls over compliance with LSC regulations (45 CFR Parts 1610, 1612 and 1617), were adequately designed. Written compliance policies and procedures, including those based on applicable recordkeeping requirements were in accordance with the respective LSC regulation.

AUDIT FINDINGS

1. Property Records for Fixed Assets

Although the Fiscal and the Information Technology Departments maintained inventory records, the listings were not reconciled with each other, and neither one contained all the relevant information as recommended by LSC's *Fundamental Criteria.* Moreover, MPLS did not maintain comprehensive property records for fixed assets purchased or received through donation.

The Accounting Guide (1997 Edition), Chapter 3, Section 3-5, *Fundamental Criteria,* requires that assets be recorded in a property subsidiary record, which includes the following specific recordkeeping information-–date acquired, description of the property including model and serial number, the check number, the original cost (if purchased), the fair value (if donated), the method of valuation (if donated), salvage value (if any), funding source, estimated life, depreciation method, identification number, and location. That is ten key elements if purchased and twelve if received through donation. Furthermore, the property subsidiary record must agree with the general ledger property accounts.

The merger in July 2000 by three different legal service providers, which established MPLS, resulted in multiple sets of property records. The IT department recorded computer-related equipment in one data base but the Fiscal department failed to consolidate the detailed equipment records from these programs. It was unclear why the property records were not consolidated and reconciled.

Properly maintained property records help ensure that fixed asset purchases are fully accounted for and safeguarded, and depreciation amounts are supported.

Recommendation 1. The Executive Director should ensure that a subsidiary property record is prepared for all fixed assets purchased or received through donation. The record should contain all information required by LSC's *Fundamental Criteria*.

Grantee Comments.

> After receiving this recommendation we examined our records and the Fundamental Criteria of the LSC Accounting Guide, our property records and our general ledger property accounts and found subsidiary property records exist for all fixed assets that were purchased. Further review shows that information for these assets is recorded as required by the Fundamental Criteria of the LSC Accounting Guide. Regarding the list that our Information Technology Department maintains, we are in the process of integrating it as part of the overall property records that exist for the

> entire organization. Finally, we are in the process of doing an inventory of all donated property, and will develop a listing of this property as required by the LSC Accounting Guide. We expect to have both these tasks completed by September 30, 2011.

OIG Evaluation of Grantee Comments. Management actions taken and planned are responsive to the recommendation. However, Recommendation 1 will remain open until all stated grantee management actions are completed and the OIG is notified of such in writing. Grantee management stated in its comments that after "receiving this recommendation," a review of its records for purchased fixed assets disclosed that all information required by LSC's Accounting Guide was recorded. This was not the case at the time of audit fieldwork. Based on information provided by management at the time of fieldwork, subsidiary property records for purchased fix assets did not contain all required information.

2. Derivative Income

A portion of MPLS's office space in Gettysburg, PA, which is leased for $1,000 per month using LSC funds, has been subleased to Regional Housing Legal Services (RHLS), a nonprofit law firm, since July 2007 for $100 per month, plus 7.5% of utilities (gas, electric and trash). However, MPLS records the income from the rent and the RHLS's share of utilities as reductions of MPLS's rent expense and the utilities accounts. Thus, MPLS has not reported the receipts from RHLS as derivative income in the audited financial statements. As of April 30, 2010, the unreported derivative income was estimated at $4,125 for the previous 34 months.

LSC's Accounting Guide, Section 2-2.7, Derivative Income states that

> LSC considers derivative income as any additional income derived from an LSC grant, such as interest income, rent or the like, or that portion of any reimbursement or recovery of direct payments to attorneys, proceeds from the sale of assets, or other compensation or income attributable to any Corporation grant. LSC derivative income must be reported in the same class of net assets that includes the LSC grant.

MPLS did not provide a specific reason as to why the derivative income from the rental of the subleased office was not properly recorded. Properly recording derivative income ensures that LSC laws, restrictions, and regulations are fully applied to all related funds.

Recommendation 2. The Executive Director should ensure that MPLS properly records income derived from rental of subleased office space.

Grantee Comments.

> When this issue was raised, the CFO changed the way the income from this sublease was recorded to comply with the regulations in the LSC Accounting Guide. This will be verified upon review of the finalized 2010/2011 audit of the IPA a copy of which we are required to send to your office.

OIG Evaluation of Grantee Comments. Management actions taken are responsive to the recommendation. Therefore, Recommendation 2 is closed.

3. Entity-wide Disaster Recovery Plan

MPLS does not have in place an entity-wide disaster recovery plan as reported by its external auditors in August 2004 in a letter to management. The Executive Director stated that MPLS has drafted a plan which was completed sometime in the spring of 2009, but it has not yet been submitted to the Board of Directors for approval. The Executive Director did not specify an exact date for its submission and implementation.

Delivery of continuous services is vital in accomplishing the grantee's mission. An effective disaster recovery plan can assist MPLS in facing an emergency, thereby minimizing the risk of disruption of legal services to the poor and protecting the assets necessary to provide those services.

Recommendation 3. The Executive Director should finalize and present to the Board of Directors for approval an entity-wide disaster recovery plan. Once approved, the Executive Director should implement the plan.

Grantee Comments.

> When this issue was raised during the OIG exit interview, it was explained that the Program had a draft entity-wide Disaster Recovery Plan which needed to be updated (due to Office relocations) so that it could be sent to the Board for approval. The Plan has been updated and it will be voted on by the MidPenn Board at its next regularly scheduled meeting on July 21, 2011.

OIG Evaluation of Grantee Comments. The actions taken are responsive to the recommendation. Management has confirmed that the MPLS Board at its July 21, 2011 meeting reviewed and approved the entity-wide disaster plan. Therefore, Recommendation 3 is closed.

4. Annotating Statements and Invoices as Paid

Of the 171 transactions tested, all the statements, invoices and other supporting documentation that were approved for payment were not marked paid or otherwise cancelled. The Accounting Guide (1997 Edition), Chapter 3-5.4, Cash Disbursements on Control over Duplicate Payments indicates that 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.

MPLS did not provide a specific reason as to why documentation approved for payment was not marked paid or otherwise cancelled. While we did not note any duplicate payments in our sample, properly annotating documents as paid will help ensure that duplicate payments are not made in the future.

Recommendation 4. The Executive Director should ensure procedures are in place to properly annotate documentation supporting disbursements as paid or otherwise cancelled to avoid duplicate payments.

Grantee Comments.

> When this issue was raised during the Monitoring visit in May 2010, the CFO (who had only been on the job since February 2010) noted that she had identified this as an issue and discussed with the monitors her plans to have this procedure become standard practice in the fiscal department. The practice of marking paid invoices as "paid" was subsequently instituted and has also been made a part of the Program's Fiscal Policies.

OIG Evaluation of Grantee Comments. Management actions taken are responsive to the recommendation. Therefore, Recommendation 4 is closed.

APPENDIX I

MidPenn Legal Services

Administration
213-A North Front Street, Harrisburg, PA 17101
Phone 717-234-0492 FAX 717-234-0496
www.midpenn.org

June 30, 2011

Ronald D. Merryman
Assistant Inspector General for Audit
3333 K Street, NW 3rd Floor
Washington, DC 20007-3558

Re: MidPenn Legal Services
Recipient Number: 339040

Dear Mr. Merryman:

This letter is written in response to the draft Office of Inspector General (OIG) report received at MidPenn Legal Services on June 3, 2011. As requested, below you will find MidPenn's response to the recommendations in your June 2, 2011, letter.

Property Records for Fixed Assets

After receiving this recommendation we examined our records and the Fundamental Criteria of the LSC Accounting Guide, our property records and our general ledger property accounts and found subsidiary property records exist for all fixed assets that were purchased. Further review shows that information for these assets is recorded as required by the Fundamental Criteria of the LSC Accounting Guide. Regarding the list that the our Information Technology Department maintains, we are in the process of integrating it as part of the overall property records that exist for the entire organization. Finally, we are in the process of doing an inventory of all donated property, and will develop a listing of this property as required by the LSC Accounting Guide. We expect to have both these tasks completed by September 30, 2011.

Derivative Income

When this issue was raised, the CFO changed the way the income from this sublease was recorded to comply with the regulations in the LSC Accounting Guide. This will be verified upon review of the finalized 2010/2011 audit of the IPA a copy of which we are required to send to your office.

Entity-wide Disaster Recovery Plan

When this issue was raised during the OIG exit interview, it was explained that the Program had a draft entity-wide Disaster Recovery Plan which needed to be updated (due to office relocations) so that it could be sent to the Board for approval. The Plan has been updated and it will be voted on by the MidPenn Board at its next regularly scheduled meeting on July 21, 2011.

Annotating Statements and Invoices as paid

When this issue was raised during the Monitoring visit in May 2010, the CFO (who had only been on the job since February 2010) noted that she had identified this as an issue and discussed with the monitors her plans to have this procedure become standard practice in the fiscal department. The practice of marking paid invoices as "paid" was subsequently instituted and has also been made a part of the Program's Fiscal Policies.

If you have questions about this letter, please feel free to contact me.

Sincerely,

Rhodia Thomas

Rhodia Thomas
Executive Director

Cc: Anthony Ramirez, Audit Team Leader