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December 21, 2012

Ms. Deierdre L. Weir
Executive Director
Legal Aid and Defender Association
613 Abbott Street
Detroit, MI 48226

Dear Ms. Weir:

Enclosed is the Office of Inspector General's (OIG) final report of our audit on Selected Internal Controls at Legal Aid and Defender Association (LADA). The OIG has reviewed your comments on the findings and recommendations in the draft report and considers the actions taken as responsive to Recommendations 7 and 8. Recommendations 7 and 8 are considered closed. The OIG considers LADA's comments on Recommendations 1, 2, 3, 4, 5, and 6 as nonresponsive and will refer these recommendations to LSC management for resolution.

We thank you and your staff for the cooperation and assistance provided to us.

Sincerely,

Jeffrey E. Schanz
Inspector General

Enclosure

cc: Legal Services Corporation
Jim Sandman
President

Lynn A. Jennings
Vice President for Grants Management

LEGAL SERVICES CORPORATION

OFFICE OF INSPECTOR GENERAL

REPORT ON SELECTED INTERNAL CONTROLS

LEGAL AID AND DEFENDER ASSOCIATION, INC.

RNO 423148

Report No. AU13-01

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INTRODUCTION

The Legal Services Corporation (LSC) Office of Inspector General (OIG) assessed the adequacy of selected internal controls at Legal Aid and Defender Association, Inc. (LADA or grantee) related to specific grantee operations and oversight. Audit work was conducted at the grantee's main office in Detroit, Michigan, and at LSC headquarters in Washington, DC. The on-site fieldwork was conducted on two separate visits from October 24, 2011 through October 28, 2011, and from January 24, 2012 through January 27, 2012. Documents reviewed pertained to the period January 1, 2010 through September 30, 2011.

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 concerns" such as defalcations and meeting the complete financial information needs of its management.

BACKGROUND INFORMATION

LADA is a Michigan non-profit corporation which provides legal services for indigent individuals. LADA is made up of four law groups and an administrative services office. The four law groups are:

> 1) State Defender Office, which represents a minimum of 25 percent of Wayne County indigent felony defendants in the Third Judicial Circuit, as appointed by the court.
> 2) Juvenile Law Group, which represents young people subject to abuse, neglect, and petition, as well as those charged with delinquency. This law group ceased active operations in July 2009.
> 3) Federal Defender Office, which is a community defender responsible for providing representation to all indigent persons charged with federal crimes in the Eastern District of Michigan.

4) Civil Law Group (CLG), which provides civil legal advice and representation in Wayne, Oakland, and Macomb counties with respect to issues related to consumer protection, landlord-tenant, family-law, and fair housing. The CLG is the only LADA law group that receives LSC funding. The CLG received $4,405,468 and $4,399,128 of LSC funds respectively in 2010 and 2011.

The Administrative Services Group (ASG) also receives a share of the LSC funding provided to the CLG. The ASG performs activities related to finance/accounting, human resources, and also includes executive management. The ASG is allotted LSC funds in proportion to labor hours spent working with the CLG on the aforementioned activities.

OBJECTIVE

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

SCOPE AND METHODOLOGY

To accomplish the audit objective, the OIG identified, reviewed, evaluated and tested internal controls related to the following activities:

- Cash disbursements
- Contracting
- Cost allocation
- Credit cards
- Derivative income
- Document management system (DMS)
- Employee benefits and reimbursements
- Internal management reporting and budgeting
- Payroll
- Property and equipment
- Vendor List

To obtain an understanding of the internal controls over these areas, the grantee's policies and procedures were reviewed, including any manuals, guidelines, memoranda, and directives setting forth current grantee policies. Grantee officials were interviewed to obtain an understanding of the internal control framework, and grantee management and staff were interviewed as to their knowledge and understanding of the processes in place. We assessed the reliability of computer generated data provided by the grantee by reviewing source documentation for the entries selected for review. We determined that the data were sufficiently reliable for the purposes of this report.

To identify, 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 Accounting Guide.

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 130 transactions allocated to LSC totaling $559,435, which represents approximately 24 percent of the amount disbursed and allocated to LSC during the period January 1, 2010 through September 30, 2011. The size of the total population of expenditures in which the disbursement sample was derived from was $2,339,618. To assess the appropriateness of grantee 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.

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

The on-site fieldwork was conducted at the grantee's central administrative office in Detroit, Michigan on two separate visits, from October 24, 2011 through October 28, 2011 and January 24, 2012 through January 27, 2012. Documents reviewed pertained to the period January 1, 2010 through September 30, 2011. The remainder of our work was conducted at LSC headquarters in Washington, DC.

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.

SCOPE LIMITATION

During the audit, we encountered a scope limitation in evaluating the adequacy of internal controls. Government auditing standards require that we report any significant constraints imposed on the audit approach by information limitations.

We requested user account profiles for the ADP payroll system with activity permissions for each user and activity logs for the ADP software program for the last two fiscal years. We requested this information from grantee personnel to verify users' individual access within the payroll process. However, we never received the information from the grantee. We contacted the grantee via email on separate occasions[1] and were told that we would receive the requested activity permissions and user logs, but to date we have not received them. The grantee's timely response was critical for us to be able to rely on the integrity of the information requested. Significant delays in its production allow an opportunity for the permissions settings to be changed or altered.

User profiles outline who is able to access the payroll system and what types of commands they can execute within the program, while activity logs record the executed commands by user for historical reference. Specifically, the activity permissions would have been utilized to ascertain who has access currently and to what extent, while the activity log would have been used to verify the user profile documents and the extent of their usage. Additionally, the activity log provides an audit trail to verify user activity within the system.

Without complete information of grantee access permissions in ADP, we could not fully evaluate whether the internal controls over this segment of the payroll process were adequate, properly designed and functioning as intended.

Grantee Comments: Grantee management stated that on February 7, 2012, an email was forwarded to the OIG listing authorized users of the ADP software program. The email indicates that there were only two users, the Human Resources (HR) Generalist and the Vice President (VP) of Finance. Grantee management stated that the OIG was informed, while on site, that both individuals have full access within the system.

Management stated that both users have full access and provided screen shots of each user profile. Management also stated that because of the PC based software used, there are limited types of reports that can be generated. As such, activity logs could not be produced for more than one pay period. However, the management comments also stated that each time payroll is generated, a report is run that shows what changes were made and the report is filed with the payroll changes for that period.

OIG Evaluation of Grantee Comments: The grantee did not provide the necessary information while we were on-site and did not timely provide the requested information once the OIG left the site. Some of the requested information that caused the scope limitation was provided with management comments to the draft report. The OIG requested access permissions for those with access to ADP and the related activity logs. This information was requested on-site and in subsequent emails on January 27, 2012 and February 1, 2012. The grantee's February 7, 2012 email only provided a list of authorized users of the ADP software. Included in the grantee's response to the

[1] On 1/27/12 and 2/1/12 we made requests to the grantee for the ADP permissions and activity logs. On 2/7/12 we received a profile from the IT contractor showing only who had access to the payroll system. We followed up on
2/10/12 with a request to the IT Contractor stating that we need both the permissions and the activity logs. We received a reply from the VP of Finance on 2/10/12 that we should receive that information by the end of the following week, but we never received it.

finding were the screen shots of the user permissions. Grantee comments contained information on obtaining the system's payroll history information we requested while on-site. The grantee did not inform us about or provide copies of the payroll change report while we were on-site. The document provided while on-site was a listing prepared by the HR Generalist of payroll changes. The listing was not an ADP system run report and we had no way of knowing whether the listing was complete and showed all payroll changes. Because we did not receive the information requested while on-site or within a reasonable period after leaving the site, the OIG reported a scope limitation that prevented us from completing all audit work planned.

OVERALL EVALUATION

Except for the scope limitation noted above, we generally found internal controls reviewed at LADA adequate as they related to specific grantee operations and oversight, including program expenditures, and fiscal accountability. Internal controls in some areas need to be strengthened and/or formalized, particularly with respect to payroll, the grantee's document management system, the administrative fee allocation and contracting.

The grantee's disbursements tested were, for the most part, adequately supported and allowable[2]. However, we did identify an instance where the grantee did not enter into a formal contract agreement with their external legal counsel. As a result, the OIG could not verify whether deliverables appropriately conformed to the agreed-upon terms between the two parties.

We found a lack of segregation of duties in the payroll process; specifically, one individual has significant control over the process. We requested access permissions to help us evaluate the controls; however, we never received them from the grantee. Due to their lack of responsiveness, we have a scope limitation that precludes us from fully evaluating internal controls in this area.

The grantee's Document Management System is lacking controls to ensure the integrity of the documentation that is imaged and stored in the system. All of the financial staff has access to modify and delete documents; however no audit trail is maintained of system activity.

Policies and procedures need to be written for both cost allocation and the administrative fee process although the related practices appear adequate. Contracting policies with respect to bid retention need to be written and need to conform to LSC's *Fundamental Criteria*.

Our evaluation and testing of controls in the areas of employee benefits, credit card purchases, internal budgeting and management reporting, property and equipment and

[2] Our conclusion is based on the documentation provided and represented by the grantee as supporting the disbursements tested.

derivative income revealed that internal controls in those areas were adequate and operating as intended.

Grantee Comments

The grantee took exception with most of the findings or portions of the findings and agreed with two of the OIG's eight recommendations. With respect to the scope limitation, the grantee provided some of the user access permission information that we requested. The grantee also provided an explanation on the activity logs and how we could obtain a history of payroll changes by reviewing a payroll change report which is filed every pay period.

The grantee disagreed with our finding and Recommendations 1, 2, and 3 on payroll and related control deficiencies. Management believed that the VP of Finance's review of payroll was a sufficient procedure to catch any errors or irregularities made by the HR Generalist while processing payroll. Management felt that the process was adequately documented and the payroll reconciliations were being performed.

The grantee also disagreed with our finding and Recommendations 4 and 5 on the Document Management System. The grantee feels the access rights are adequate and no activity log is needed.

Management comments stated that the grantee did have a formal written policy for the allocation of administrative fees in the Accounting Policies and Procedures Manual and attached a copy. As such, management felt Recommendation 6 had already been addressed.

The grantee agreed with Recommendations 7 and 8. The grantee indicated that wording was added to its contracting policy with respect to the retention of bids and that formal agreements will be obtained in the future.

OIG's Evaluation of Grantee Comments

The OIG considers the grantee's actions taken to be responsive to Recommendations 7 and 8, and considers these recommendations closed. The OIG considers the grantee's comments on Recommendations 1, 2, 3, 4, 5, and 6 as non-nonresponsive and will refer these recommendations to LSC management for resolution. These six recommendations will remain open until such time as written notification is received by the OIG that all resolution actions have been completed on each recommendation.

While the grantee provided, with management's comments, some of the information that caused the scope limitation, the information was not sufficient or timely enough to be considered. We do not know what the conditions were at the time of our audit, and thus cannot express an opinion based on this information.

The OIG disagrees with grantee management's comments pertaining to payroll and related control deficiencies identified by the audit. We do not agree that the process was adequately documented in part because the accounting manual only detailed the VP of Finance duties and responsibilities for payroll. The payroll reconciliation process was described in management's comments; however, no documentation or evidence showing that the reconciliations were actually performed was provided.

The OIG also disagrees with the grantee assessment on the Document Management System. The OIG believes the grantee has not adequately assessed the impact of all finance staff being able to create, modify and delete documents and the benefits that would be obtained from maintaining an activity log to track changes made by those employees. As stated in the finding, without restricted access or review of activity logs, documents could be deleted or altered without the knowledge of grantee management.

The formal written policy on the administrative fee formula that the grantee submitted does not address the issue that we identified in the finding. The written policy does not address how the administrative fee allocated to the CLG is subsequently allocated to the CLG funding sources, such as LSC.

The wording the grantee added to its contracting policies on retaining bids appears adequate. Management's actions to obtain retainer agreements in the future for legal services are responsive.

AUDIT FINDINGS

PAYROLL SCOPE LIMITATION AND RELATED CONTROL DEFICIENCES

Our review of the payroll process at the grantee revealed deficiencies in the payroll process and related internal controls. We determined that the Human Resource (HR) Generalist, who has almost unrestricted access in the payroll system, is extensively involved in the payroll process. There was no evidence that payroll reconciliations, which act as a payroll control, were being performed although we were told by grantee management that they were done regularly. We requested to review the reconciliations but were told that the grantee did not have them.

We also requested the access permissions for the payroll system and the related activity logs, but were not provided them by the grantee. As a result, we have a scope limitation on our audit. Without complete information available to us on the grantee's payroll system, we could not fully evaluate whether the related internal controls were properly designed and functioning as intended. The access permissions would let us know who within LADA has access to the payroll system and what levels of authority they have to perform tasks in that system. The activity logs track all changes made to various records and files within the system. They also serve as a historical record and identify whose User ID made the various changes.

Segregation of Incompatible Duties

Our discussions with the HR Generalist revealed that she performs both personnel and payroll functions. These duties are routinely performed by the employee as part of her job responsibilities. The duties are incompatible duties which may increase the risk that fraud could occur and not be detected. She can create, modify, and remove employee information in the grantee's payroll system, a personnel function. She also performs timekeeping duties in that system such as entering time for employees which is the basis for them being paid.

The HR Generalist's abilities within the payroll system, without any compensating controls or adequate review of her work, allows the opportunity for fraud, such as creating fictitious employees and entering time for them. Our discussions with the HR Generalist revealed that she also has the ability to reactivate employees and enter time for them. When there is no form of compensating controls in place, a misappropriation is not only possible, it may go undetected for a long period of time. As stated above, we tried to confirm the HR Generalist's precise administrative permissions within the payroll system, and whether any other employees had access, but were not provided that information by the grantee, resulting in our scope limitation.

The LSC Accounting Guide identifies the segregation of duties as a significant component of an adequate internal control structure. 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. This component reduces the likelihood of an employee having an opportunity to commit fraud against the grantee or its stakeholders.

Reconciliation of Payroll Payments

Grantee management stated that payroll reconciliations are performed monthly to ensure that amounts paid and processed are accurate. To perform this reconciliation the grantee stated that it uses both payroll records and human resource records. However, the grantee could not provide documentary evidence to support the assertion that payroll reconciliations are performed. The grantee also does not have written policies and procedures detailing the payroll reconciliation process to be followed. Considering that the HR Generalist performs both personnel and payroll duties, it is imperative that this reconciliation be performed. Since the grantee did not maintain evidence of this reconciliation we could not determine whether this control was in place and operating effectively.

A strong system of internal controls requires that significant procedures and the results of applying those procedures, such as reconciling payroll, be adequately documented. Once completed, reconciliations should be reviewed and approved by a responsible official. Independent and documented reconciliations can substantially decrease the likelihood of irregular or improper disbursements and increase the likelihood that errors will be discovered and corrected in a timely manner.

Recommendations

The Executive Director should:

Recommendation 1. Ensure that the duties and responsibilities of the HR Generalist with respect to the personnel and payroll functions are adequately segregated so that she performs no incompatible duties.

Recommendation 2. Formulate written policies and procedures detailing the payroll reconciliation process and ensure this process and related internal controls are communicated and understood by all relevant personnel.

Recommendation 3. Ensure payroll reconciliations are performed and documented on a monthly basis by personnel independent of the payroll processing and recording procedures and that management reviews the reconciliations in a timely manner.

Grantee Comments: The grantee disagreed with the finding and related recommendations regarding payroll issues. Grantee management responded that the HR Generalist has the responsibility for entering LADA's semi-monthly payroll data. The grantee further stated that work is reviewed by the VP of Finance, who verifies that all data has been entered correctly. Management indicated that a second review of payroll is completed when the payroll checks are sorted and distributed. As such, the grantee believes that the HR Generalist's duties do not need to be segregated as the OIG suggests in Recommendation 1, and the process is sufficient because of the additional review of the HR Generalist's work. The grantee stated that the payroll process and the reconciliation process are already documented in its Accounting Policies and Procedures Manual. Grantee management states that payroll reconciliations are performed regularly and are sufficient to identify any discrepancies, which are then corrected and entered into ADP during the next payroll process. Management comments described in general terms the payroll reconciliation process. As such, the grantee believes that the OIG's Recommendation 3 with regards to payroll reconciliations is already addressed.

OIG's Evaluation of Grantee Comments: The grantee comments are not responsive to the OIG's recommendations. With respect to Recommendation 1, the grantee claims the independent reviews that are performed of the HR Generalist's work adequately address the segregation issues the OIG identified. The grantee states that the payroll changes made by the HR Generalist are reviewed by the VP of Finance. However, the process does not ensure that all the payroll changes get to the VP of Finance for review. The HR Generalist forwards a list of the changes she made, not a computer generated list of all payroll changes. Thus, changes can be made by the HR Generalist in both the personnel and payroll systems without any assurance that all changes have been forwarded and reviewed by the VP of Finance.

With respect to Recommendation 2, payroll policy and procedures contained in the grantee's accounting manual concerning payroll reconciliations do not explicitly include a detailed description of the entire process. Rather, the procedures detail the actions taken by the VP of Finance and not a description of other staff members' roles and responsibilities, including those actions taken by the HR Generalist.

Regarding Recommendation 3, grantee management did not provide any evidence that the reconciliations were actually performed and documented on a monthly basis by personnel independent of the payroll processing and recording procedures and that management reviews the reconciliations in a timely manner.

We will refer these matters to LSC management for resolution. The OIG considers recommendations 1, 2, and 3 open until the OIG receives written notification from the grantee that all resolution actions have been completed.

CONTROL WEAKNESSES IN THE DOCUMENT MANAGEMENT SYSTEM

Our review of the grantee's Document Management System (DMS) identified various weaknesses in controls over maintaining the integrity of documents imaged within the system. The DMS is a digital image archive system that the grantee has used since fiscal year 2006, which allows the grantee to dispose of its paper records while preserving a digital image of the documents. The grantee uses DMS to image casework records, finance records and human resource records. The grantee currently has a validation process in place in which it batches documents to be scanned and imaged. Once the documents are scanned into DMS, the employee who scanned the documents compares the scanned product to the original documents to ensure that it is correct before closing out the batch.

The VP of Finance, the Financial Assistant and the Grants Manager are Finance Office employees, all of whom have access rights to create, modify, and delete accounting documentation within DMS. Also, the activity log that tracks changes made to documents by users is not turned on, and consequently, no tracking is performed. Best practices dictate that the access rights to these functions should be significantly limited so as to preserve the integrity of the physical audit trail. Currently the only control over access is the employee's user ID and related password. However, the employees still have all the rights in the system mentioned above and that control does not mitigate the risk that the integrity of the documents could be violated.

The DMS has a monitoring control function known as the Audit Log, which automatically (if enabled) tracks and records all activities performed in DMS by date, time and user account. We discussed the audit log with the Information Systems contractor and he informed us that it had been turned off because the file size gets too large over time and consumes server space. We observed the DMS settings with the audit function turned off. Therefore, there is no way of knowing if any changes or alterations or deletions have been made to any original documents. Consequently, there could be unauthorized changes to financial documents without management approval or knowledge.

During the course of our audit, no evidence came to our attention that any documentation in this system had been altered or changed.

Recommendations

The Executive Director should:

Recommendation 4. Ensure accounting staff's access rights to the DMS are reasonably limited in terms of creation, modification, and deletion as to protect the integrity of pertinent accounting information.

Recommendation 5. Ensure the DMS' Activity Log is enabled to track and monitor all activities performed in DMS as to identify unauthorized, irregular, or improper activities.

Grantee Comments: The grantee disagreed with the finding and Recommendations 4 and 5. Grantee management stated that the finance staff must have full access rights to the DMS to create, modify and/or delete items in the system. Grantee management stated that making a change on the documents stored in the DMS has no financial impact on the organization. Grantee management states that an activity log would only identify additions or deletions, but would not identify what documents were altered or removed. Management stated that since using DMS in 2006, staff has always been able to produce a complete and accurate document (with support) for vendors, auditors, or staff members upon request.

OIG Evaluation of Grantee Comments: The grantee's comments are not responsive to Recommendations 4 and 5. We disagree with management that all finance staff members must have full access rights to create, modify, and delete items in the system, and that the documents stored in the DMS have no financial impact on the grantee.

While the electronic filing system activities may be no different than a "traditional paper" file cabinet system, even a paper based file system should have reasonable controls over who can create, modify and delete items. Electronic file systems tend to include easier ways to implement controls by using automation to restrict access, track what is being done, and document who is taking the action within the system. Creating, modifying, or deleting documents in any system, paper based or electronic, should require some formal approval process to ensure that all activity is properly authorized and known, and can be verified. It also seems that deeper problems may exist if the volume of modifications and deletions is so large that everyone must be able to modify or delete items already approved to be in the system. Also, electronic systems provide new and expanded opportunities for undetected or malicious activities that paper based systems do not have such as remote access from computers. If an authorized user's computer is hacked, the whole electronic filing system could be available to the person hacking. Restricting access permissions is a way of limiting the damage that a hacker can inflict.

We believe the documents stored in the DMS do have a financial impact on the grantee. If the information on the document has been recorded in the accounting system and the document is subsequently modified or deleted, the grantee may not be able to support charges made to a specific grant. The cost recorded in the accounting system may then be disallowed and thus have a financial impact on the organization.

We will refer this matter to LSC management for resolution. The OIG considers Recommendations 4 and 5 open until such time as written notification is received by the OIG that all resolution actions have been completed.

ADMINISTRATIVE FEE ALLOCATION PROCESS NEEDS TO BE DOCUMENTED

Allocation of the Administrative Fee to LSC

There are no documented policies and procedures that describe how the administrative fee assessed to the CLG is subsequently allocated to the LSC Basic Field Grant.

The administrative fee signifies the expenses incurred by the ASG while performing financial and other support services for all of LADA's law groups. The purpose of the administrative fee is to match the ASG's expenses with law group revenues since the ASG does not perform law-related activities and therefore has no specific funding source. The ASG mostly consists of Human Resources, Finance/Accounting, and Executive Management.

The CLG is allocated a portion of the annual administrative fee based on a year-end time study of ASG hours attributed to assisting the CLG. The time study is a method of identifying hours worked by staff on the different groups. Hours worked by ASG staff are recorded on a worksheet and allocated to whichever law group benefited from those hours. A percentage of ASG hours worked for each law group is then determined and used to allocate the administrative fee among the different groups.

The CLG's portion of the administrative fee is further allocated to funding sources such as LSC, based on the availability of funds; however, there are no policies and procedures documenting this process. Furthermore, since funds contributed by non-LSC sources are normally scarce at fiscal year-end, LSC normally incurs the largest brunt of the administrative fee assessed to the CLG, which makes it important that LADA be transparent about the process applied to allow for greater control and oversight of LSC funds.

In order to test the administrative fee, we reviewed allocation tables and performed recalculations prepared by the grantee. However, since there were no written criteria available, we based our analysis on the grantee's practices, specifically the allocation of

ASG cost in accordance with percentages calculated from the time study. This process was revealed to us through our discussions with the VP of Finance.

The LSC *Fundamental Criteria* requires the cost allocation formula be adequately documented in writing with sufficient detail for the auditor, LSC, OIG, GAO, and others, to easily understand, follow, and test the formula. Unless the allocation process is properly designed, adequately documented, and accurately applied, the grantee cannot be assured that its costs are being allocated to LSC and other funding sources in a consistent and equitable manner.

Recommendation

The Executive Director should:

Recommendation 6. Formulate detailed, written policies and procedures for allocating the CLG's administrative fee among LSC and other funding sources.

Grantee Comments: Grantee management stated that they have a formal written policy for the allocation of administrative fees in its Accounting Policies and Procedures Manual, and provided a copy of that policy and the associated allocation formula.

OIG Evaluation of Grantee Comments: Grantee comments are not responsive to Recommendation 6. The administrative fee calculation policy that is now in the grantee's accounting manual does not document how the administrative fee, charged to the CLG, is subsequently allocated to funding sources within the CLG, including LSC. It only describes how the administrative fee is allocated to the CLG. Management comments did not address the issue of allocating the administrative fee among the CLG funding sources. The OIG will refer this matter to LSC management for resolution. The OIG considers Recommendation 6 open until such time as written notification is received by the OIG that all resolution actions have been completed.

CONTRACTING NEEDS IMPROVEMENT

Our audit revealed deficiencies in contracting at LADA. The grantee's written policies do not require them to maintain evidence that competition was sought for large contracts as required in the *Fundamental Criteria*. Also, for one particular vendor, the grantee did not maintain the formal contract agreement as required by its own contracting policies.

Policies and Procedures on Retention of Contract Bids and Proposals

LADA's contracting policies are not in accordance with the *Fundamental Criteria*, which requires retaining documentation that supports the level of competition considered by the grantee prior to entering into contractual agreements for products and services.

LADA does not have specific written contracting policies that require them to maintain bids or any evidence of competition for large contracts.

We requested all contracts during the period as part of our normal contracting audit procedures and confirmed that LADA does not maintain bids. When we inquired about the bids, LADA provided board minutes which illustrated that the grantee normally presents at least 3 bid proposals to their Board of Directors for feedback and approval before entering into contracts that cost greater than $10,000. However, after a contractor is approved, the bid proposals are not retained by LADA.

For large contracts, retaining proper documentation of competition provides evidence that the grantee has made an effort to obtain the best value and price for goods and services related to the contract. Documents supporting competition should be retained and kept with the contract files in a centralized location.

No Formal Contract Agreement

LADA failed to enter into a formal contract agreement with external legal counsel. The *Fundamental Criteria* requires that each contract action be fully documented while sufficiently detailing the statement of work so that contract deliverables can be identified and monitored to ensure compliance with agreed-upon terms. Without a formal contract, the statement of work along with other contract terms cannot be adequately communicated and monitored, which may obstruct management's ability to prevent or detect the risk of fraud, waste, and abuse.

LADA's accounting manual also requires that all agreements for professional services be made in writing and clearly define the contract terms and services. The grantee did not follow its own policy. The VP of Finance informed us that there was no formal contract with the contractor serving as LADA's legal counsel. She also stated that the contractor has been LADA's legal counsel for over 20 years.

All nine billings from the contractor were processed and paid for by LADA in accordance with its established policies and procedures. However, due to the lack of a formal contract agreement, the OIG was unable to verify whether the nine payments aligned with the terms agreed upon by both parties.

Recommendations

The Executive Director should:

Recommendation 7. Formulate policies and procedures that are in conformity with the *Fundamental Criteria* and adopt practices for retaining all bid proposals associated with securing contractual agreements.

Recommendation 8. Ensure that all products and services obtained or performed within specific, agreed-upon terms be supported by a formal agreement, as stated in the grantee's policies and procedures.

Grantee Comments: Grantee management stated that wording (approved by the Board of Directors at its September 20th meeting) was added to LADA policies and procedures on contracting that allow for retention of bids. Grantee management stated policies and procedures are now in place to ensure contracts are supported by a formal agreement. Management stated that the contractor identified in the report was for legal services and was LADA's counsel before the Accounting Policies and Procedures Manual was adopted. A retainer will be obtained for this contractor in the future.

OIG Evaluation of Grantee Comments: Grantee actions taken are responsive to Recommendations 7 and 8. The grantee provided a copy of the revised policies and procedures with respect to retaining bids and obtaining formal agreements. The OIG considers Recommendations 7 and 8 closed.

APPENDIX I

CENTENNIAL 1909 2009
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September 21, 2012

Ronald D. Merryman
Assistant Inspector General for Audit
Office of Inspector General
Legal Services Corporation
3333 K. Street, NW 3rd Floor
Washington, DC 20007-3522

RE: Draft Report on Selected Internal Controls

Dear Mr. Merryman,

This letter is in response to the Office of Inspector General Legal Services Corporation's letter dated July 17, 2012 regarding Legal Aid and Defender Association's (LAD) Draft Report on Selected Internal Controls. LAD's responses are attached.

If you have any questions or need additional information, please contact Angela Smith, V.P. of Finance, at asmith@ladadetroit.org or 313-967-5602.

Sincerely,

Deierdre L. Weir

Deierdre L. Weir
President & CEO

Attachment

LEGAL AID AND DEFENDER ASSOCIATION, INC
LSC REPORT ON SELECTED INTERNAL CONTROLS RESPONSE

SCOPE LIMITATION

On February 7, 2012, the attached email was forwarded to the auditor showing the authorized users of the ADP software program. This email shows that Lynn McLeod (HR Generalist) and Angela Smith (V.P. Finance) are the only two individuals that have access to the ADP system. The auditors were informed, while on site, that both individuals have full access to the system to perform payroll functions in the absence of the other individual (see response to Recommendations 1 through 3 for further explanation).

On February 10, 2012, the auditor requested the following two items:

1. **User accounts access permissions (there should be at least 3 sets)**
   Both users have full access; however, after speaking with ADP, LAD has taken screen shots of each user profile (attached). Both profiles are the same.

2. **User activity logs for the last two fiscal years.**
   Again, after speaking with ADP, LAD was informed that because the PC based software is used (instead of the online software), LAD is limited in the types of reports that can be generated and is therefore unable to produce activity logs for more than one pay period. LAD does run a report each time payroll is generated that shows what changes were made and the report is filed with the payroll changes for that period.

Recommendations

The Executive Director should:

Recommendation 1: Ensure that the duties and responsibilities of the HR Generalist with respect to the personnel and payroll functions are adequately segregated so the she performs no incompatible duties.

Recommendation 2: Formulate written policies and procedures detailing the payroll reconciliation process and ensure this process and related internal controls are communicated and understood by all relevant personnel.

Recommendation 3: Ensure payroll reconciliations are performed and documented on a monthly basis by personnel independent of the payroll processing and recording procedures and that management reviews the reconciliations in a timely manner.

Response

The Payroll Process is documented in the Accounting Policies and Procedures Manual (see attached). While the HR Generalist has the responsibility for entering LAD's semi-monthly payroll changes, it is the V.P. Finance's responsibility to verify data entered. The HR Generalist is only allowed to enter changes that have been properly documented and authorized by either the President & CEO, Law Group Chief or the employee.

As outlined in the manual, payroll will be received unopened by the ASG Executive Assistant who will forward to the correct person for review (newly approved by the Board on September 20th). When the HR Generalist processes payroll, all payroll changes (original documents) will be forwarded to the V.P. Finance to compare to data entered. The V.P. Finance verifies that all changes have the proper approvals and that changes have been entered correctly. The two ADP registers used to verify payroll are the "Payroll Audit Report" and the "Payroll Register." Any discrepancies are identified, corrected, and entered into ADP during the next payroll process. All payroll changes (original documents) are returned to HR after review for filing.

A second review of payroll is completed when the payroll checks are sorted and distributed. A review and reconciliation is also completed when payroll data is entered into Labor Distribution Schedule from the ADP payroll registers. Once the Labor Distribution Schedule is completed, the data is entered into the MIP Accounting System. It is important to note that neither the HR Generalist nor the V.P. Finance enters data into the MIP Accounting System.

Management's statement that payroll reconciliations are performed monthly relates to the reviewing and reconciling of the payroll data entered in the MIP Accounting system. The V.P. Finance is responsible for reviewing and reconciling all accounting entries (including payroll) monthly, prior to the production of financial statements. The semi-monthly reconciliation of ADP payroll using authorized payroll changes received from Human Resources is outlined above.

CONTROL WEAKNESSES IN THE DOCUMENT MANAGEMENT SYSTEM

Recommendations

The Executive Director should:

Recommendation 4: Ensure accounting staff's access rights to the DMS is reasonably limited in terms of creation, modification, and deletion as to protect the integrity of pertinent accounting information.

Recommendation 5: Ensure the DMS's Activity Log is enabled to track and monitor all activities performed in DMS as to identify unauthorized, irregular, or improper activities.

Response

The Document Management System (DMS) serves as an electronic filing cabinet. That fact aside, the Finance staff must have full access rights to the DMS to create, modify and/or delete items in the system. DMS activities are no different than if LAD were utilizing a "traditional paper" file cabinet system, where each staff member would be able to add, delete, or modify any document within the file cabinet system (without creating a log for changes and or deletions).

The Grants Manager and the Accounting Clerk are the two individuals responsible for adding Finance documents to the system. They must be able to make sure that all required back up documentation is attached and correct. For example, the Accounting Clerk is responsible for adding "Travel Reports" to the Per Diem check payments after an employee has returned from a trip. Also as an example, it is the Grant Manager's responsibility to audit the system for duplicates, blank pages, etc. Both examples requires full access to the system.

Any changes to an accounts payable document (which impacts the financial statements) are easily traced through the MIP Accounting program, which has its own audit trail system. Making a change on the document stored in the DMS has no financial impact on the organization. A DMS activity log would only identify additions or deletions, but it would not identify what documents were altered or removed. Therefore, the need to limit and/or document through an activity log is not necessary.

It is important to note, that since Finance started using the DMS in 2006, staff has always been able to produce a complete and accurate document (with support) for vendors, auditors, or staff members upon request.

ADMINISTRATIVE FEE ALLOCATION PROCESS NEEDS TO BE DOCUMENTED

Recommendations

The Executive Director should:

Recommendation 6: Formulated detailed, written policies and procedures for allocating the CLG's administrative fee among LSC and other funding sources.

Response

LAD has a formal written policy for the allocation of administrative fees in the Accounting Policies and Procedures manual (see attached).

CONTRACTING NEEDS IMPROVEMENT

Recommendations

The Executive Director should:

Recommendation 7: Formulate policies and procedures that are in conformity with the Fundamental Criteria and adopt practices for retaining all bid proposals associated with securing contractual agreements.

Recommendation 8: Ensure that all products and services obtained or performed within specific, agreed-upon terms be supported by a formal agreement, as stated in the grantees policies and procedures.

Response

LAD has policies and procedures in place to ensure contracts are supported by a formal agreement; however, wording has been added (and approved by the Board of Director's – September 20th) to the Accounting Manual to allow for the retention of all bid proposals. For the one contractor stated in the report for legal services, the vendor was LAD's legal counsel before LAD's Accounting Policies and Procedures manual was adopted. Future services with this vendor will require a client retainer letter. All services requiring contracts since the adoption of the manual, have followed procedure.