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Legal Services Corporation

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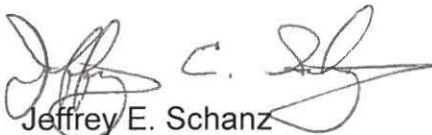
Mr. Michael Taylor  
Board Chair  
Appalachian Research & Defense Fund of Kentucky, Inc.  
1406 U.S. Highway 25 E  
Middlesboro, KY 40965

Dear Mr. Taylor:

Enclosed is the Office of Inspector General's final report on the results of our audit on Selected Internal Controls at Appalachian Research & Defense Fund of Kentucky, Inc. We have reviewed the response to the Overall Recommendation in the draft report and believe the proposed actions address the issues. The Overall Recommendation is open until all stated management actions are taken and the OIG is notified in writing and has evaluated the actions taken.

Our thanks to the Appalachian Research & Defense Fund of Kentucky, Inc. staff for the courtesy and cooperation provided during this audit.

Sincerely,

  
Jeffrey E. Schanz  
Inspector General

Enclosure

cc: James Sandman, President  
Legal Services Corporation

Jonathan Picklesimer, Interim Executive Director  
Appalachian Research & Defense Fund of Kentucky, Inc.

**LEGAL SERVICES CORPORATION  
OFFICE OF INSPECTOR GENERAL**

**REPORT ON SELECTED INTERNAL CONTROLS**

**APPALACHIAN RESEARCH AND DEFENSE FUND  
OF KENTUCKY**

**RNO 618030**

Report No. AU11-05

August 2011

[www.oig.lsc.gov](http://www.oig.lsc.gov)

## EXECUTIVE SUMMARY

**Audit Process:** The Legal Services Corporation (LSC) Office of Inspector General (OIG) assessed the adequacy of selected internal controls in place at Appalachian Research and Defense Fund of Kentucky (AppalReD or grantee) related to grantee operations and oversight. Audit work was conducted at the grantee's main office in Prestonsburg, Kentucky, and at LSC headquarters in Washington, DC. The on-site fieldwork was conducted from March 1, 2011 to March 10, 2011.

**Results in Brief:** Taken as a whole, the control deficiencies identified in this report constitute a material weakness in AppalReD's internal control system. A material weakness in an internal control system may result in impairments to the effectiveness and efficiency of operations; misstatements in financial and performance information; or violations of laws and regulations not being prevented, detected or corrected by management or staff in the normal course of business in a timely manner. In our opinion, AppalReD's management does not have adequate assurance that LSC funds spent on the delivery of legal services and the related support services have been made in accordance with LSC grant terms and conditions.

Generally, the OIG identified many areas where internal controls and accounting processes at AppalReD needed improvement. The internal control weaknesses lead us to question the reliability of the information we received and raised questions about the integrity of the amounts generated from the accounting system and presented to us during the period under review. Six people had unrestricted access to multiple incompatible aspects of the grantee's accounting system. Approximately 77 percent of all the disbursements tested were either unsupported or inadequately supported. Also, an invoice for the approximately \$64,000 cost of new teleconferencing equipment was not recorded in the accounting system, reportedly because the grantee did not have the funds available to pay the invoice. Lack of funds is not a valid reason for not recording legitimate purchases in the accounting records. The OIG could not determine whether this was the only such invoice not recorded or if there were other unrecorded invoices.

Specifically, controls and processes need to be developed to address the deficiencies as presented on pages 6 - 17 in the body of the report. As a result of the deficiencies cited in the report, the OIG is questioning \$257,057 in costs charged to LSC funds.

These conditions likely occurred because the grantee had not established or enforced an adequate system of internal controls, and the staff did not have the knowledge, skills, and abilities necessary to properly operate the controls and accounting system.

**Recommendation:** The OIG is making one overall recommendation. In implementing the overall recommendation, the OIG expects that all issues contained in the report will be addressed. The OIG recommends that AppalReD's Board of Directors obtain the services of a skilled individual(s), not associated with the grantee, to review the internal control design, accounting process and accounting department organizational structure and implement changes, in accordance with LSC requirements, to ensure that the

grantee's resources are properly controlled, accounted for, and safeguarded. The individual(s) should assess the personnel needs of the department and provide any necessary training to the employees in the accounting department or recruit qualified individuals to perform such duties.

**Summary of Grantee Comments:** According to comments provided by the Interim Executive Director, AppalReD's Board of Directors concurred with the recommendation to obtain services of skilled individual(s) to review the internal control design, accounting process and accounting department organization. Training will be provided to key personnel and Board members. All training is planned to be completed by the end of 2011. The comments provided by the Interim Executive Director also stated that "...current administrative management team has made remarkable strides since the beginning of 2011 to implement and train key personnel on internal control and departmental structure."

In addition to providing comments on the overall recommendation, comments were provided for each finding. These comments are included in the body of the report after each finding.

**OIG Evaluation of Grantee Comments:** The OIG views grantee comments as responsive to the overall recommendation. However, the OIG is concerned the grantee's response was provided by the Interim Executive Director and not the Chair of AppalReD's Board of Directors. The letter transmitting the draft report and requesting comments from the Board was addressed to the Chair. The overall recommendation was addressed to the Board of Directors. The OIG is also concerned because some of the comments provided addressing each finding seem to conflict with implementing the overall recommendation. There is no indication in the comments that the Board agrees with the comments provided by the Interim Executive Director or that the Board has reviewed the accuracy of the information contained in the comments.

In addition to its evaluation of grantee comments related to the overall recommendation, the OIG provided an evaluation of grantee comments for specific findings when deemed necessary. For these findings, the evaluation is included following the "Grantee Comments" paragraph.

## TABLE OF CONTENTS

|   |    |
|---|----|
| INTRODUCTION .....  | 1  |
| BACKGROUND .....  | 1  |
| OBJECTIVE.....  | 1  |
| SCOPE AND METHODOLOGY .....   | 2  |
| SCOPE LIMITATION.....   | 3  |
| OVERALL EVALUATION .....  | 3  |
| OVERALL RECOMMENDATION .....  | 5  |
| Grantee Comments.....   | 5  |
| OIG Evaluation of Grantee Comments.....                               | 5  |
| AUDIT FINDINGS.....   | 6  |
| Outdated and Incomplete Accounting Manual.....                        | 6  |
| Grantee Comments .....  | 7  |
| Cost Allocation .....   | 7  |
| Grantee Comments .....  | 7  |
| OIG Evaluation of Grantee Comments .....                              | 8  |
| Consultants/Contractors.....  | 8  |
| Grantee Comments .....  | 9  |
| OIG Evaluation of Grantee Comments .....                              | 9  |
| Multiple Deficiencies within the Purchasing/Disbursement Process..... | 9  |
| Grantee Comments .....  | 10 |
| Internal Management Reporting and Budgeting.....                      | 10 |
| Grantee Comments .....  | 10 |
| OIG Evaluation of Grantee Comments .....                              | 11 |
| Employee Loan Programs.....   | 11 |
| Grantee Comments .....  | 12 |
| OIG Evaluation of Grantee Comments .....                              | 12 |
| Vehicle Management Needs Improvement .....                            | 12 |
| Grantee Comments .....  | 12 |

## **TABLE OF CONTENTS (Continued)**

|  |    |
|--|----|
| Car Insurance Premiums .....                           | 12 |
| Grantee Comments .....                                 | 13 |
| OIG Evaluation of Grantee Comments .....               | 13 |
| Disposal of Vehicles.....                              | 13 |
| Grantee Comments .....                                 | 13 |
| Accounting Matters and Concern .....                   | 14 |
| Travel Advances .....                                  | 14 |
| Grantee Comments .....                                 | 14 |
| OIG Evaluation of Grantee Comments .....               | 14 |
| Accounting System Access .....                         | 14 |
| Grantee Comments .....                                 | 15 |
| Unrecorded Expenditures .....                          | 15 |
| Grantee Comments .....                                 | 15 |
| OIG Evaluation of Grantee Comments .....               | 15 |
| Unsupported Student Loan Reimbursement .....           | 16 |
| Grantee Comments .....                                 | 16 |
| OIG Evaluation of Grantee Comments .....               | 16 |
| Property Management.....                               | 17 |
| Grantee Comments .....                                 | 17 |
| Accounting Function and Organizational Structure ..... | 17 |
| Grantee Comments .....                                 | 18 |
| OIG Evaluation of Grantee Comments .....               | 18 |

### APPENDIX I – GRANTEE COMMENTS

## **INTRODUCTION**

This audit is a result of allegations the Office of Inspector General (OIG) received about activities at Appalachian Research and Defense Fund of Kentucky (AppalReD or grantee). Because of the seriousness of the allegations and in order to address the allegations in a timely matter, the OIG conducted an audit that focused on AppalReD's disbursements and its accounting treatment of certain transactions, including the related internal controls.

## **BACKGROUND**

In accordance with the Legal Services Corporation Accounting Guide for LSC Recipients (2010 Edition)<sup>1</sup> (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 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 AppalReD, in particular as the controls related to specific grantee financial operations and oversight, including grantee expenditures and fiscal accountability. 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.

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<sup>1</sup> 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).

Specifically, the OIG (1) assessed whether selected expenditures were properly charged to LSC funds, and (2) determined whether certain transactions were properly recorded in AppalReD's accounting records. The OIG also assessed specific internal controls dealing with issues identified. The audit was limited in scope and was not sufficient for expressing an opinion on the entire system of grantee internal controls over financial operations.

## **SCOPE AND METHODOLOGY**

To accomplish the objective, the OIG reviewed transactions and procedures, and tested internal controls associated with disbursements; internal management reporting and budgeting; employee benefits (including employee loans and student loan assistance payments); property management; selected accounting system operations; contracting processes; and cost allocation methodology. To obtain an understanding of the internal controls over these areas, grantee policies and procedures were reviewed, including manuals, guidelines, memoranda, and directives setting forth current grantee practices. Grantee officials were interviewed to obtain an understanding of the internal control framework. Grantee management and staff were interviewed as to their knowledge and understanding of the processes in place.

Initially, 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. During the audit, the OIG discovered that numerous individuals had complete access to all facets of the accounting system and because the system was new, the staff was not fully knowledgeable in how to use the system, resulting in accounting errors. As a result, the OIG had no assurance the computer generated data was reliable and relied on computer generated data only to estimate questioned costs and to confirm some reported findings<sup>2</sup>. Other than access controls, the OIG did not test the general or application controls over the computer system.

To test for appropriateness of expenditures and the existence of adequate supporting documentation, disbursements from a judgmentally selected sample of employee vendor and credit card files were reviewed. The sample represented 3.3 percent of the over \$4.6 million grantee disbursements made during the period January 1, 2009 to December 31, 2010 and consisted of 253 transactions, totaling \$154,870. 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 and applicable laws and regulations. For the other areas reviewed, we performed tests to determine whether the areas were being administered in accordance with the grantee's internal policies or LSC's Accounting Guide.

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<sup>2</sup> For example, while we traced six disbursements for the student loan assistance program to appropriate documentation, we estimated the resulting questioned costs based on the total amount of disbursements recorded in the system for the student loan program. However, we can provide no assurance that the amount charged to student loans in the system, in total, is accurate.



The on-site fieldwork was conducted from March 1, 2011 to March 10, 2011. Documents reviewed pertained to January 1, 2009 to December 31, 2010. Our work was conducted at the grantee's central administrative office located in Prestonsburg, Kentucky, and at the LSC headquarters in Washington, DC.

The 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.

AppalReD did not have available a grantee accounting manual reflecting the policies and procedures currently in place. Grantee management stated that the accounting manual provided to the OIG was significantly out of date and did not reflect current operations. Without complete and current documentation of the grantee's control system, we could not fully evaluate whether the internal controls were properly designed and functioning as intended. However, our limited internal control review revealed the absence of necessary controls as well as the risk of management override of the limited controls in place. Of those controls that were reportedly in place, many were not being followed. All of this taken as a whole leads us to question the reliability of the grantee's financial records and information generated from its accounting system.

Our review of the accounting records allowed us to formulate some general conclusions about the grantee's internal control structure. We accumulated the necessary information to support the findings and conclusions contained in this report; however, we cannot conclude on the reliability of any other financial information outside of the information we reviewed. We did not audit every area of the grantee's accounting system. As such, we cannot offer an opinion of the controls in those areas that we did not review. In addition, we cannot provide any level of assurance that the information contained in the accounting system or the information generated from the accounting system can be relied upon.

### **OVERALL EVALUATION**

Taken as a whole, the control deficiencies identified in this report constitute a material weakness in AppalReD's internal control system. A material weakness in an internal control system may result in impairments to the effectiveness and efficiency of operations; misstatements in financial and performance information; or violations of

laws and regulations not being prevented, detected or corrected by management or staff in the normal course of business in a timely manner. In our opinion, AppalReD's management does not have adequate assurance that LSC funds spent on the delivery of legal services and the related support services have been made in accordance with LSC grant terms and conditions. As a result of the deficiencies cited in the report, the OIG is questioning \$257,057 in costs charged to LSC funds.

Generally, the OIG identified many areas where internal controls and accounting processes at AppalReD needed improvement. The internal control weaknesses lead us to question the reliability of the information that we received and raised questions about the integrity of the amounts generated from the accounting system and represented to us during the period under review. Six people had full access to all aspects of the grantee's accounting system. Approximately 77 percent of all the disbursements tested were either unsupported or inadequately supported. Also, an invoice for the approximately \$64,000 cost of new teleconferencing equipment was not recorded in the accounting system because the grantee did not have the funds available to pay the invoice. Lack of funds is not a valid reason for not recording legitimate purchases in the accounting records. The OIG could not determine whether this was the only such invoice not recorded or whether there were other unrecorded invoices.

Specifically, controls and processes need to be developed to address the following deficiencies:

- Out-of-date and incomplete accounting manual.
- Lack of explanation or documentation on how the cost allocation percentages were set up in the new Accounting System.
- Inability to prepare monthly financial reports by fund because indirect cost allocations to the various sources of funds were only made at year end.
- Lack of adequate controls in place to ensure unallowable costs other than bar dues are not charged to LSC funds.
- Lack of a system in place requiring written contracts for services provided and review of deliverables to ensure completion of agreed upon terms.
- Unsupported or inadequately documented disbursements.
- Inadequate budget planning and lack of all major monthly budget reports.
- Loans not made in accordance with grantee written policy.
- Both non payback and untimely payback of employee loans.
- Continued car insurance payments on vehicles sold or no longer in use.
- Costs of a locally developed student loan assistance program charged to LSC basic funds without adequate support.
- Grantee maintains an unwritten policy to allow family members and friends to accompany employees on grantee related travel. No system in place to ensure family members and friends repaid the grantee for the travel.
- No receiving reports providing assurance that goods ordered were received.
- Travel advances made months in advance of the travel dates and expensed immediately instead of being appropriately set up as a receivable.
- Lack of reconciliations of travel expenses.

- Unrecorded invoice (teleconferencing equipment).
- Access to the accounting system not properly restricted.

These conditions likely occurred because the grantee had not established or enforced an adequate system of internal controls. Also, the staff did not have the knowledge, skills, and abilities necessary to properly apply the controls or operate the accounting system.

### **OVERALL RECOMMENDATION**

AppalReD's Board of Directors should obtain the services of a skilled individual(s), not associated with the grantee, to review the internal control design, accounting process and accounting department organizational structure; and should implement, in accordance with LSC requirements, changes to ensure that the grantee's resources are properly controlled, accounted for, and safeguarded. The individual(s) should assess the personnel needs of the department and provide any necessary training to the employees in the accounting department or recruit qualified individuals to perform such duties.

#### **Grantee Comments.**

AppalReD's Board of Directors concurs with the recommendation to obtain services of skilled individual(s) to review the internal control design, accounting process and accounting department organization and have already held discussions with regard to this and plan to obtain these services in the near future. Arrangements are already in place not only to train key personnel, but also to provide a much needed Board Member Training as well. We are hopeful to have all administrative personnel as well as Board members trained by the end of 2011.

Meanwhile, AppalReD's current administrative management team has made remarkable strides since the beginning of 2011 to implement and train key personnel on internal control and departmental structure. In December 2010, one of our current administrative personnel attended the Financial Management seminar presented by Gerry Singsen. In May 2011, she trained other administrative personnel and made each one aware of the LSC Financial Management requirements. As indicated in the previous paragraph, we are prepared to send other staff to financial management trainings as they come available.

**OIG Evaluation of Grantee Comments.** While the OIG is accepting grantee comments as responsive to the recommendation, the OIG is concerned the grantee's response was provided by the Interim Executive Director and not the Chair of AppalReD's Board of Directors. The letter transmitting the draft report and requesting comments from the Board was addressed to the Chair. The recommendation was addressed to the Board of Directors. In the letter from the Interim Executive Director transmitting the grantee's

comments to this report, there is no mention of the Board's involvement or agreement with the comments. There are references to the Board's involvement in some of the comments. However, other comments seem to conflict with implementing the Overall Recommendation. As a result, the OIG does not have assurance that the Board agrees with all of the comments presented or has reviewed the accuracy of the information contained in the comments. The Overall Recommendation will remain open until management has notified the OIG in writing of all actions completed and the OIG has evaluated those actions. In addition to the Overall Recommendation, grantee management provided comments for each finding. These comments are listed below the applicable finding. The OIG reviewed these comments and, when deemed necessary, included an "OIG Evaluation of Grantee Comments" paragraph following the "Grantee Comments" paragraph.

## **AUDIT FINDINGS**

Below are the OIG's detailed findings. Because of the system-wide internal control weaknesses disclosed, recommendations are not made for each finding. By implementing the overall recommendation, the entire system should be addressed including the specific areas listed below.

The findings identified below are those issues that are the most significant based on the OIG's review of the grantee's accounting records and associated internal control processes. Some of these findings contain questioned costs that the OIG will refer to LSC management for further action.

### **Outdated and Incomplete Accounting Manual**

The grantee's accounting manual was outdated. A review of the manual revealed that many needed policies are absent, and some of the procedures for processing transactions are not current. We performed a comparison of AppalReD's accounting manual to the controls, policies and procedures identified as part of the Fundamental Criteria in LSC's Accounting Guide. We found the grantee's accounting manual to be deficient in the areas noted below.

- The accounting manual lacked written policies or had inadequate or incomplete policies in the following areas: cost allocation, contracting, budgeting, inventory (property), vehicle management, disposal of fixed assets, credit card usage, cell phones, laptops, and ethics.
- Although the accounting manual contained a whistleblower policy, it does not mention that the LSC OIG can also be contacted to report fraud, waste or abuse.
- The manual did not accurately define the responsibilities of the accounting department with respect to processing, recording and reporting financial transactions.

- Policies pertaining to transaction processing need updating. They include the purchasing, accounts payable/disbursement, payroll and cash receipts.

### Grantee Comments.

AppalReD's Board of Directors has formed a Policies and Procedures Committee that is reviewing all of AppalReD's policies, procedures, and operating guides. AppalReD's Accounting Manual is being reviewed and revised by the Policies and Procedures Committee. Once revised, the manual will be presented to the Board for review in September 2011 and submitted for final approval at the Board's December 2011 meeting. The accounting manual will contain updated policies as recommended as well as documentation of procedures for reporting fraud, waste or abuse to LSC. The revised manual will also define the specific responsibilities of the accounting department with respect to processing, recording and reporting of financial transactions. All policies pertaining to the transaction processing such as purchasing, accounts payable/disbursement, payroll and cash receipts will also be revised. The revised manual will require AppalReD to meet all of the requirements established in 45 CFR §1630. AppalReD will implement measures to ensure that the Accounting Manual is followed and all requirements are being met and are presently following OIG's recommendation in the interim while the manual is being revised.

### Cost Allocation

Our review of the indirect cost allocation process revealed that there are no written policies and procedures documented for FY's 2009 and 2010 in the grantee's accounting manual. Our review of the practice in place disclosed that the grantee performs allocations on a spreadsheet outside of the accounting system. The final allocation calculations are not recorded in the general ledger, but are reported on the financial statement.

The new accounting system allows the grantee to set up pre-determined allocation percentages for different line items. The old accounting system used in FY 2009 and the first six months of FY 2010 did not have this capability. These percentages were set up for the second six months of 2010 and all of 2011. However, the system was not used to allocate costs for 2010. While we were informed by the Interim Executive Director that the grantee intended to use the new system to allocate by transaction for 2011, no one working in the accounting department knew the basis or rationale behind the allocation percentages. As such, we could not make a determination on whether the allocation percentages were fair and reasonable.

### Grantee Comments.

In June 2010, AppalReD purchased and installed the SAGE MIP Fund Accounting System. This new accounting system has the capabilities to

accurately allocate expenses as they are incurred. Now that the system has been installed and staff have had training and gained a better understanding of how the system allocates expenditures, AppalReD is in a better position to accurately allocate these expenses. Currently as invoices are received, expenses are coded to the correct fund source and allocated as the invoice is being entered into the system. AppalReD's CFO reviews these transactions for accurate allocation and monitors the entries weekly. This ensures that LSC funds have been properly allocated and creates measures to prevent unallowable costs to be charged against those funds. AppalReD's Policies and Procedures Committee is presently preparing written policies and procedures for the program's Accounting Manual outlining these procedures which will be presented to the Board in September 2011. The cost allocation methodology will be fully documented in the Manual at that time. In the interim, AppalReD has implemented these procedures to ensure compliance.

Further, the audit team expressed concern over the use of allocation codes and the appropriate documentation of those codes. AppalReD has discontinued the use of these codes and is reconsidering the role of this functionality.

OIG Evaluation of Grantee Comments. Grantee management's comment was partially responsive. While management has reported that progress has been made in implementing and documenting a cost allocation system, the OIG is still concerned as to whether the final system implemented will fairly and reasonably allocate costs among all funding sources. The OIG was not concerned that allocation codes were used. Rather, the OIG was concerned that the basis for the allocation percentages assigned to the codes could not be explained and thus whether management had sufficient knowledge of the rationale behind the allocation percentages.

### **Consultants/Contractors**

The grantee does not have formal written contracting procedures. Formal written policies and procedures are vital to a strong structure ensuring that the established controls are communicated to all staff, a consistent approach is taken when using contractors, and that appropriate approvals and authorizations are obtained.

The grantee does not consistently enter into formal contract agreements. Management could not provide contract agreements for 16 of the 22 contracts selected for review<sup>3</sup>. For the six that were provided, the contract file did not contain documentation showing that the grantee obtained quotes or bids in order to obtain the best possible price and service. However, the contracts did contain the estimated cost, parties involved and a description of services to be provided. Also, since a large number of written contracts

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<sup>3</sup> The OIG originally compiled a list of 15 consultant contracts based on information provided by the grantee. The Interim Executive Director added seven more that were not on our list. As such, we have no assurance that all of the consulting contracts were identified.

were missing, we were unable to determine whether the expenditures paid were for agreed upon services, whether deliverables were received as expected, and appropriate value was received for the monies spent. As a result, we are questioning payments made to 16 contractors for services provided, totaling \$94,199.50.

We requested supporting documentation related to the purchase of the new SAGE accounting system, however, the grantee could not provide any of the related invoices or contracts. We could not determine through the general ledger the total cost of the system. The Interim Executive Director stated that the total cost was around \$70,000. Because documentation of the purchase was not available to review, we are questioning this amount as an unsupported cost.

#### Grantee Comments.

AppalReD has implemented procedures that will assure its compliance with the requirements set out in the 2010 Accounting Guide for LSC Recipients with regard to obtaining the services of consultants/contractors. The purpose of all consultant contracts will be adequately supported and will clearly describe the services rendered or to be rendered to support such expenditures. Measures have been implemented to ensure that all items required by contractors are received and meet the contractual requirements. These procedures will be included in AppalReD's Accounting Manual. Supporting documentation has been provided to OIG prior to the receipt of this draft audit with regard to the SAGE MIP Fund Accounting System.

OIG Evaluation of Grantee Comments. Grantee management planned actions are fully responsive to the contracting issue identified by the OIG. However, documentation supporting the purchase of the SAGE MIP Fund Accounting System has not been provided.

#### **Multiple Deficiencies within the Purchasing/Disbursement Process**

Disbursements were not properly supported or processed, or they were inappropriately charged to LSC funds. Of the 253 disbursements reviewed, 194 disbursements (77 percent) had one or more of the following problems:

- 184 transactions lacked adequate support.
- 52 transactions were not properly approved.
- 16 transactions were recorded in the wrong account or lacked account numbers.
- 109 transactions were inappropriately allocated to LSC funds.

The following internal control deficiencies were also identified:

- Lack of segregation of duties in the purchasing of IT equipment. One individual was responsible for initiating purchases, approving those purchases, and receiving those goods and services.
- Receiving reports were not used to verify the receipt of goods prior to payment. In general, payments made to vendors are not supported by documentation indicating that the goods or services paid for were actually received. As a result, the OIG is questioning \$16,755.76 of disbursements made by AppalReD, which includes \$8,464.76 in credit card purchases.

#### Grantee Comments.

AppalReD's Accounting Manual is being revised and will be presented to AppalReD's Board for review in September and submitted for final approval of the Board at its December 2011 meeting. The revised manual will require appropriate documentation to support expenditures charged against LSC Funds. The manual will also provide a segregation of duties for approval of purchases and processes for receiving goods and services. In the interim, AppalReD has implemented measures to assure that the purchasing and disbursement process follows the requirements set out in 45 CFR §1630.

#### **Internal Management Reporting and Budgeting**

For FY 2009 and FY 2010, the grantee conducted virtually no budget planning according to the current Interim Executive Director. In general, to formulate upcoming budgets, the Interim Executive Director stated that the practice was just to add 3 percent or 4 percent to the prior year budget numbers. These amounts were presented as the upcoming budget although the amounts did not adequately project grantee expenses and revenues for the upcoming year.

The OIG was also informed by the Interim Executive Director that there were no internal management reports being generated on a periodic basis or in a consistent manner to monitor the grantee's financial position and use of funds during the year.

#### Grantee Comments.

Unfortunately, during your program visit, the former CFO who carried out the duties of internal management reporting and budgeting for the programs prior 30 years was not available for explanation as to budget formulations for 2010 and prior program years. During the former CFO's 30-year tenure with the program, reports were being generated on a periodic basis and in a consistent manner to monitor our financial position and use of funds throughout the year. It was not only until 2010 when the



former CFO decided to retire from the program permanently. At which time, no training was given to newly hired CFO's, to carry out the duties in a well-managed manner.

Presently, AppalReD's Board feels that the needs for internal management reporting and budgeting are being met and well managed by its current administrative personnel. Personnel have been trained to oversee fund balances and monitor expenses and revenues for the entire program. The current accounting software used by the program allows entering of the approved Fiscal Year Budget which provides a complete analysis of current and upcoming expenses and revenues. These reports are being monitored and provided to key staff and Board on a regular basis.

The Board of Directors as [sic] approved a Budget for 2011 and has instructed that the Administration report to the Finance Committee of the Board monthly on the financial status of the firm. Additionally, monthly expense reports are being generated and shared with program managers.

OIG Evaluation of Grantee Comments. Grantee management's response is not consistent with the explanation provided on-site to the OIG with respect to budgeting and management reporting at the program. While on-site, the grantee's explanation made no distinction made between FY 2010 and prior years as stated in the grantee's written response. If during years prior to FY 2010 the budget process was different than it currently is, the OIG was not informed of this difference. Also, the OIG was told that in the FY 2011, very little reporting was taking place and an effort was being made to develop the type of reports that would be useful to management.

### **Employee Loan Programs**

Our audit revealed significant deficiencies in the administration of the grantee's employee loan programs. The grantee has clearly defined written policies with respect to employee loans. In practice, many of the policies were not consistently followed. Specifically:

- The former Executive Director approved her own emergency loans without any Board approval;
- Employees obtained new loans before fully paying back outstanding balances from previous loans;
- Justifications for the loans were inadequate and incomplete and not in accordance with grantee policy;
- No evidence of employees going to a credit union to get a loan as required by AppalReD policy;
- Loans were not paid back in accordance with loan agreements. (There was very little payback from July 2010 to December 2010. The accounting staff apparently

did not understand how to set up the payroll deduction in the new accounting system.)

- Emergency loans were required to be secured by the employee's accrued vacation according to grantee policy, yet there was no written policy on disallowing employee use of accrued vacation if used to secure a loan.

#### Grantee Comments.

AppalReD's Employee Loan Program has been discontinued by the Board until we've had adequate time to revise the procedures for disbursing such loans. In the meanwhile, all current outstanding loans have adequate loan documentation and payments are being automatically set up within the present accounting software to withhold those payments until the loans are paid in full.

OIG Evaluation of Grantee Comments. Grantee comments do not address the specific issue raised in this finding. The grantee had clearly defined policies in place; however, these policies were not consistently followed. Grantee comments indicate that procedures for disbursing employee loans are being revised. Grantee comments contain no information on how management is going to ensure that the new policies will be followed to prevent such abuse and misuse from occurring again.

#### **Vehicle Management Needs Improvement**

At the time of our visit, AppalReD owned a fleet of 15 vehicles for employees to use to perform grantee business. However, the grantee does not have written policies on managing or disposing of vehicles. As a result, the grantee was paying car insurance on vehicles it no longer owned and on vehicles that were inoperable.

#### Grantee Comments.

AppalReD's Board has established a Policies and Procedures Committee which is addressing the need for proper policies [sic] for vehicle management and disposal of vehicles for the program.

Car Insurance Premiums. Our review of the related car insurance policy revealed that the grantee paid car insurance on three vehicles for a number of years after the vehicles were disposed of and were no longer grantee vehicles. Also, at least two vehicles at the Prestonsburg, Kentucky office that were nonfunctional had car insurance premiums still being paid annually on those vehicles. Approximately 75 percent of the related car insurance expenses for these vehicles were charged to LSC funds.

**Overpaid Auto Insurance Premiums**

| <b>Vehicle</b>       | <b>Yearly premium</b> | <b>Amount Questioned<sup>4</sup></b> | <b>Years Overpaid</b> |
|----------------------|-----------------------|--------------------------------------|-----------------------|
| 1998 Toyota Camry    | \$851                 | \$2,978.52                           | 2006 thru 2011        |
| 1985 Chevy Cavalier  | 592                   | 3,033.98                             | 2002 thru 2008        |
| 1986 Chevy Cavalier  | 592                   | 2,774.99                             | 2002 thru 2008        |
| 2000 Kia Sephia      | 830                   | 1,245.00                             | 2009 thru 2010        |
| 1996 Chevy Astro Van | 841                   | 3,153.75                             | 2006 thru 2010        |
| <b>Total</b>         |                       | <b>\$13,186.24</b>                   |                       |

**Source:** Travelers umbrella insurance policy

**Note:** The beginning and ending years may not be a full 12 months

The OIG is questioning \$13,186.24 of insurance costs paid for with LSC funds, during the period these vehicles were unnecessarily insured.

Grantee Comments.

Program’s monitoring of car insurance premiums for AppalReD’s current fleet of 13 vehicles has been recently updated. Although two vehicles at the Prestonsburg, Kentucky Office location were nonfunctional and remained to be covered under the program’s insurance policy, recommendation was made by the programs insurance carrier to maintain coverage on those vehicles until disposal as a result of the vehicles being stored in a public parking area.

OIG Evaluation of Grantee Comments. Grantee management response states that program monitoring of car insurance premiums has been updated but does not state how it has been updated or the type of new controls in place to prevent this from occurring again. The response also indicates that two vehicles at Prestonsburg are nonfunctional, but insured because they are parked in a public area. However, there is no mention of the steps management will take to ensure quick disposal of the vehicles. Maintaining insurance on nonfunctional vehicles until disposal may be reasonable if the vehicles are sold quickly. However, maintaining insurance on nonfunctional vehicles for extended periods is questionable.

Disposal of Vehicles. Also, the grantee does not have a policy or clearly established process on the disposal of vehicles that are no longer needed or inoperable.

Grantee Comments.

AppalReD’s Board of Directors is in the process of reviewing the necessity of procedures for disposal of vehicles within the program. A committee

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<sup>4</sup> This amount is based on the allocation percentage for LSC’s portion of insurance expense in 2009 of 75%. At the time of our audit, the 2010 allocation had not yet been performed.

has been established and is currently involved in the creation of and implementation of these policies.

### **Accounting Matters and Concerns**

During our review of the grantee's accounting records, several accounting issues came to our attention.

Travel Advances. All eleven of the travel advances we reviewed were initially being recorded as an expense instead of as a receivable, even though some of the advances were made up to two months prior to date of travel. Also, there was no reconciliation of the expenses incurred after completion of travel to determine if any amount of the advance was due back to the grantee.

### **Grantee Comments.**

Travel advances provided by the program are based upon the current federal per diem rate and are provided to personnel for out-of-state travel. During the previous director's tenure, she did request these per diems nearly 2-months in advance of the planned travel. Although under the prior directorship these advances were made so far in advance of the travel, this is not the case under the current program leadership. The program's policies and procedures for Travel Advance requests are currently being followed and are being well documented and reconciled accordingly.

OIG Evaluation of Grantee Comments. Grantee comments are not responsive to the finding. The OIG stated that travel advances were initially being recorded as an expense instead of as a receivable; however, the grantee does not comment on how the grantee is going to address this accounting issue. The grantee comment also does not address whether the grantee is going to review prior year outstanding travel advances to ensure they are properly reconciled and any monies owed or due are settled.

Accounting System Access. Access to the accounting system is not adequately controlled. Six individuals within AppalReD, of whom two were former employees, had full access to the new SAGE accounting system to record, prepare, edit, disburse, and modify organization history<sup>5</sup>. The following individuals had that access:

1. The former Executive Director
2. Interim Executive Director
3. Accounting Contractor (Former Chief Financial Officer)

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<sup>5</sup> The organizational history is a tracking function for all activity and transactions performed by employees within the accounting system including changes, additions, deletions, logins and logouts. The organization history also notes the exact time these activities occurred.

4. Interim Chief Financial Officer
5. Accountant
6. A/P purchasing clerk

These individuals make up the majority of the current accounting staff. As a result, the opportunity for malfeasance is high. The accounting system has ample capabilities to segregate incompatible duties through its activities permissions, but the current setup does not take advantage of this internal control feature.

Grantee Comments.

All current Administrative Personnel have limited access to the program's accounting system. Due to the lack of knowledge of the set up operations during the initial installation of the software, some personnel may have been set up with full access by the SAGE program installer and trainer. As indicated in your report, the current accounting system has ample capabilities to segregate incompatible duties through its activities permissions and the system has been updated to assure the establishment of restrictions has been set in place.

Unrecorded Expenditures. The invoice for the new teleconferencing equipment was not entered into the accounting system as an accounts payable at the time of our on-site visit. The Interim Executive Director indicated that it was due to insufficient funds to pay for the equipment. The cost of this equipment was approximately \$64,000 and was purchased in December 2010. As a result, any financial reports produced after the invoice was received may have been materially misstated.

Also, we inquired about the supporting documentation for the new SAGE accounting system. We were not provided with a contract or the related invoices. Additionally, we were not able to trace the expenditure into the general ledger nor determine whether it was a legitimate cost allocable to LSC.

Grantee Comments.

Currently, all financial obligations of the firm are recorded properly in the financial system and appropriate [sic] supporting documentation exists for all of these transactions. These records are being maintained within the current accounting software program and reflected on the program's financial reports.

OIG Evaluation of Grantee Comments. While grantee management's comments indicate that all financial obligations have been properly recorded, the OIG still has not received the supporting documentation for the purchase of the Sage MIP Fund Accounting System. Also, the OIG is concerned that the cost of the teleconferencing equipment was not recorded against the proper fiscal year. The comment does not

delineate management's understanding that this practice is improper and does not include any planned controls or practices to ensure this does not occur again.

### **Unsupported Student Loan Reimbursement**

AppalReD management developed and implemented a student loan assistance program outside of LSC's Loan Repayment Assistance Program (LRAP). Each participant is eligible for up to \$4,500 in assistance payments per year. There is no maximum amount per participant. A portion of the payments are charged to LSC basic field funds. At the time of the audit, approximately 20 staff members were receiving payments under this program.

We examined 6 expenditures related to 4 of the 20 participants receiving reimbursements and found that agreements or adequate student loan documentation were not on file and could not be provided for review. As a result, it was unclear whether or not employees being awarded student loan assistance payments qualified under the AppalReD student loan assistance program.

The total amount paid out as Student loan reimbursements was \$115,849 over two years, with \$56,469 and \$59,380 being paid in FY 2009 and FY 2010, respectively. Because grantee management has not been enforcing its policies and obtaining appropriate supporting documentation, the OIG is questioning the portion of student loan assistance program payments charged to LSC amounting to approximately \$62,916 in FY 2009 and FY 2010 as unsupported costs.

### **Grantee Comments.**

Supporting documentation for each employee who participates in the Student Loan Reimbursement program exists within each individual's personnel file. Information as to the amount of outstanding loan principle is obtained every six-months from each individual. Loan reimbursement is closely monitored in accordance with the current Operating Guidelines for Student Loan Repayment Assistance Program. Also, current recipients of the student loan assistance are required to provide signed certification that during the previous six months, all the financial assistance received from AppalReD has been applied towards the total amount repaid. Staff are in place to assure the continued monitoring of this program benefit.

OIG Evaluation of Grantee Comments. While grantee management indicates the supporting documentation exists within each individual's file, sufficient documentation was not located and provided to the OIG when requested during the course of the audit. The limited documentation received and reviewed by the OIG did not adequately support the loan payments. If adequate documentation existed within the personnel file at the time of audit fieldwork, it was not made available for our review.

## **Property Management**

Our review of AppalReD's property indicated that the grantee has adequate practices in place to manage its property. However, the written policies documenting these practices are insufficient and need improvement. We compared the grantee's practices to LSC's Fundamental Criteria and found that the practices were generally in accordance with LSC requirements. However, we note that AppalReD's inventory listing did not include all the fields required by the LSC Accounting Guide for LSC Recipients. The inventory listing was missing the asset identification number and funding source fields. The fixed asset spreadsheet, which records all capitalized assets, was not updated timely with respect to additions or deletions and was only updated at year end. Also, the spreadsheet does not reflect on a timely basis transfers of assets between office locations.

### **Grantee Comments.**

AppalReD's Board agrees with LSC's recommendation to update its practices with regard to its property management. The current Policies and Procedures Committee will be reviewing the process by which property is managed by the program and will be updating and implementing these policies within the current year. AppalReD's inventory listing will be updated to include all the fields required by LSC's Accounting Guide for LSC Recipients. The fixed asset spreadsheet is being monitored on a regular basis and is being updated accordingly.

## **Accounting Function and Organizational Structure**

The current organizational structure needs to be evaluated and an adequate system designed with the related job duties and responsibilities clearly defined. The accounting department is currently going through transition and staffing levels need to be established. AppalReD currently has two former employees playing significant roles in the accounting function. These two individuals are former AppalReD employees with a significant amount of operational experience in the accounting department. We were informed by the Interim ED that the two former employees are only temporary, and as such, their duties and responsibilities will have to be picked up by other accounting staff.

In addition, we requested job descriptions of the current staff in the accounting department. We were provided job descriptions, but were told by the Interim CFO that the job descriptions were out of date and did not truly represent the duties and responsibilities of the staff during our period of review. We were not provided with an explanation for why they were outdated. We also examined those job descriptions and determined that they did not adequately reflect the position, duties and responsibilities of the current accounting personnel. Accurate position descriptions help ensure that employees with the right skills are hired for the right jobs and that employees know their job responsibilities.

### Grantee Comments.

The overall accounting function and organization structure of AppalReD's current administrative personnel has changed drastically since the beginning of 2011. AppalReD's Board feels confident that the current staff are maintaining LSC's financial management requirements and have addressed and continue to address internal control and management needs as they arise. The current Policies and Procedures Committee is reviewing all personnel job descriptions and will be updating those for the entire program by the end of 2011. Meanwhile, administrative staff are performing individual functions as required to ensure internal controls within the programs fiscal management.

OIG Evaluation of Grantee Comments. Grantee comments do not describe how the accounting function and organization structure has drastically changed from what was observed by the OIG during audit fieldwork conducted in March, 2011. This representation appears to be inconsistent with the grantee's response to our overall recommendation in which the grantee indicated that it would hire appropriate individual(s) from outside of the program to review the organizational structure, internal control design and accounting process.



## APPALACHIAN RESEARCH AND DEFENSE FUND OF KENTUCKY, INC.

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July 8, 2011

Inspector General Jeffrey E. Schanz  
Office of Inspector General  
Legal Services Corporation  
3333 K Street, NW, 3<sup>rd</sup> Floor  
Washington, DC 2007-3558

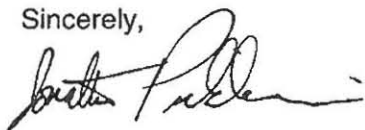
Dear Inspector General Schanz:

We have received and reviewed your June 8, 2011, correspondence containing the draft report on the results of your audit of Selected Internal Controls at our organization. We appreciate any and all recommendations that you can provide and have provided to us with regard to internal controls within our organization.

Mr. Hart and the audit team were very professional and very helpful in their recommendations while they were on site. It goes without saying that the program has experienced unprecedented challenges in 2011.

Enclosed is our response to the draft report issued by the audit team on June 8, 2011. We recognize that while we have made considerable progress on reestablishing appropriate internal controls and fiscal policy since the audit team's visit, there is still considerable work to be completed in the coming months. We look forward to a future audit from OIG with more positive outcomes.

Sincerely,



Jonathan Picklesimer  
Interim Executive Director

Enc: Response to the Office of the Inspector General Report, June 8, 2011

Cc: Mike Taylor  
Donna Hale



Response to the Office of the Inspector General Report, June 8, 2011

**OVERALL RECOMMENDATION**

AppalReD's Board of Directors should obtain the services of a skilled individual(s), not associated with the grantee, to review the internal control design, accounting process and accounting department organizational structure; and implement, in accordance with LSC requirements, changes to ensure that the grantee's resources are properly controlled, accounted for, and safeguarded. The individual(s) should assess the personnel needs of the department and provide any necessary training to the employees in the accounting department or recruit qualified individuals to perform such duties.

Response

AppalReD's Board of Directors concurs with the recommendation to obtain services of skilled individual(s) to review the internal control design, accounting process and accounting department organization and have already held discussions with regard to this and plan to obtain these services in the near future. Arrangements are already in place not only to train key personnel, but also to provide a much needed Board Member Training as well. We are hopeful to have all administrative personnel as well as Board members trained by the end of 2011.

Meanwhile, AppalReD's current administrative management team has made remarkable strides since the beginning of 2011 to implement and train key personnel on internal control and departmental structure. In December 2010, one of our current administrative personnel attended the Financial Management seminar presented by Gerry Singen. In May 2011, she trained other administrative personnel and made each one aware of the LSC Financial Management requirements. As indicated in the previous paragraph, we are prepared to send other staff to financial management trainings as they come available.

**AUDIT FINDINGS**

Below are the OIG's detailed findings. Because of the system-wide internal control weaknesses disclosed, recommendations are not made for each finding. By implementing the overall recommendation, the entire system should be addressed including the specific areas listed below.

The findings identified below are those issues that are the most significant based on the OIG's review of the grantee's accounting records and associated internal control processes. Some of these findings contain questioned costs that the OIG will refer to LSC management for further action.

Outdated and Incomplete Accounting Manual

The grantee's accounting manual was outdated. A review of the manual revealed that many needed policies are absent, and some of the procedures for processing transactions are not

## Appalachian Research and Defense Fund of Kentucky RNO 618030

current. We performed a comparison of AppalReD's accounting manual to the controls, policies and procedures identified as part of the Fundamental Criteria in LSC's Accounting Guide. We found the grantee's accounting manual to be deficient in the areas noted below.

- The accounting manual lacked written policies or had inadequate or incomplete policies in the following areas: cost allocation, contracting, budgeting, inventory (property), vehicle management, disposal of fixed assets, credit card usage, cell phones, laptops, and ethics.
- Although the accounting manual contained a whistleblower policy, it does not mention that LSC can also be contacted to report fraud, waste or abuse.
- The manual did not accurately define the responsibilities of the accounting department with respect to processing, recording and reporting financial transactions.
- Policies pertaining to transaction processing needed updating. They include the purchasing, accounts payable/disbursement, payroll and cash receipts.

### Response

AppalReD's Board of Directors has formed a Policies and Procedures Committee that is reviewing all of AppalReD's policies, procedures, and operating guides. AppalReD's Accounting Manual is being reviewed and revised by the Policies and Procedures Committee. Once revised, the manual will be presented to the Board for review in September 2011 and submitted for final approval at the Board's December 2011 meeting. The accounting manual will contain updated policies as recommended as well as documentation of procedures for reporting fraud, waste or abuse to LSC. The revised manual will also define the specific responsibilities of the accounting department with respect to processing, recording and reporting of financial transactions. All policies pertaining to the transaction processing such as purchasing, accounts payable/disbursement, payroll and cash receipts will also be revised. The revised manual will require AppalReD to meet all of the requirements established in 45 CFR §1630. AppalReD will implement measures to ensure that the Accounting Manual is followed and all requirements are being met and are presently following OIG's recommendation in the interim while the manual is being revised.

### Cost Allocation

Our review of the indirect cost allocation process revealed that there are no written policies and procedures documented for FY's 2009 and 2010 in the grantee's accounting manual. Our review of the practice in place disclosed that the grantee performs allocations on a spreadsheet outside of the accounting system. The final allocation calculations are not recorded in the general ledger, but are reported on the financial statement.

The new accounting system allows the grantee to set up pre-determined allocation percentages for different line. The old accounting system used in FY 2009 and the first six months of FY 2010 did not have this capability. These percentages were set up for the second six months of 2010 and a" of 2011. However, the system was not used to allocate costs for 2010. While we

## Appalachian Research and Defense Fund of Kentucky RNO 618030

were informed by the Interim Executive Director that the grantee intended to use the new system to allocate by transaction for 2011, no one working in the accounting department knew the basis or rationale behind the allocation percentages. As such, we could not make a determination on whether the allocation percentages were fair and reasonable.

### Response

In June 2010, AppalReD purchased and installed the SAGE MIP Fund Accounting System. This new accounting system has the capabilities to accurately allocate expenses as they are incurred. Now that the system has been installed and staff have had training and gained a better understanding of how the system allocates expenditures, AppalReD is in a better position to accurately allocate these expenses. Currently as invoices are received, expenses are coded to the correct fund source and allocated as the invoice is being entered into the system. AppalReD's CFO reviews these transactions for accurate allocation and monitors the entries weekly. This ensures that LSC funds have been properly allocated and creates measures to prevent unallowable costs to be charged against those funds. AppalReD's Policies and Procedures Committee are presently preparing written policies and procedures for the program's Accounting Manual outlining these procedures which will be presented to the Board in September 2011. The cost allocation methodology will be fully documented in the Manual at that time. In the interim, AppalReD has implemented these procedures to ensure compliance.

Further, the audit team expressed concern over the use of allocation codes and the appropriate documentation of those codes. AppalReD has discontinued the use of these codes and is reconsidering the role of this functionality.

### Consultants/Contractors

The grantee does not have formal written contracting procedures. Formal written policies and procedures are vital to a strong structure ensuring that the established controls are communicated to all staff, a consistent approach is taken when using contractors, and that appropriate approvals and authorizations are obtained.

The grantee does not consistently enter into formal contract agreements. Management could not provide contract agreements for 16 of the 22 contracts selected for review. For the six that were provided, the contract file did not contain documentation showing that the grantee obtained quotes or bids in order to obtain the best possible price and service. However, the contracts did contain the estimated cost, parties involved and a description of services to be provided. Also, since a large number of written contracts were missing, we were unable to determine whether the expenditures paid were for agreed upon services, whether deliverables were received as expected and appropriate value was received for the monies spent. As a result, we are questioning payments made to 16 contractors for services provided totaling \$94,199.50.

We requested supporting documentation related to the purchase of the new SAGE accounting system, however, the grantee could not provide any of the related invoices or contracts. We could not determine through the general ledger the total cost of the system. The Interim

## Appalachian Research and Defense Fund of Kentucky RNO 618030

Executive Director stated that the total cost was around \$70,000. Because documentation of the purchase was not available to review, we are questioning this amount as an unsupported cost.

### Response

AppalReD has implemented procedures that will assure its compliance with the requirements set out in the 2010 Accounting Guide for LSC Recipients with regard to obtaining the services of consultants/contractors. The purpose of all consultant contracts will be adequately supported and will clearly describe the services rendered or to be rendered to support such expenditures. Measures have been implemented to ensure that all items required by contractors are received and meet the contractual requirements. These procedures will be included in AppalReD's Accounting Manual. Supporting documentation has been provided to OIG prior to the receipt of this draft audit with regard to the SAGE MIP Fund Accounting System.

### Multiple Deficiencies within the Purchasing/Disbursement Process

Disbursements were not properly supported or processed, or they were inappropriately charged to LSC funds. Of the 253 disbursements reviewed, 194 disbursements (77 percent) had one or more of the following problems:

- 184 transactions lacked adequate support.
- 52 transactions were not properly approved.
- 16 transactions were recorded in the wrong account or lacked account numbers.
- 109 transactions were inappropriately allocated to LSC funds.

The following internal control deficiencies were also identified:

- Lack of segregation of duties in the purchasing of IT equipment. One individual was responsible for initiating purchases, approving those purchases, and receiving those goods and services.
- Receiving reports were not used to verify the receipt of goods prior to payment. In general, payments made to vendors are not supported by documentation indicating that the goods or services paid for were actually received. As a result, the OIG is questioning \$16,755.76 of disbursements made by AppalReD, which includes \$8,464.76 in credit card purchases.

### Response

AppalReD's Accounting Manual is being revised and will be presented to AppalReD's Board for review in September and submitted for final approval of the Board at its December 2011 meeting. The revised manual will require appropriate documentation to support expenditures charged against LSC Funds. The manual will also provide a segregation of duties for approval of purchases and processes for receiving goods and services. In the interim, AppalReD has implemented measures to assure that the purchasing and disbursement process follows the requirements set out in 45 CFR §1630.



## Appalachian Research and Defense Fund of Kentucky RNO 618030

### Internal Management Reporting and Budgeting

For FY 2009 and FY 2010, the grantee conducted virtually no budget planning according to the current Interim Executive Director. In general, to formulate upcoming budgets, the Interim Executive Director stated that the practice was just to add 3% or 4% to the prior year budget numbers. These amounts were presented as the upcoming budget although the amounts did not adequately project grantee expenses and revenues for the upcoming year.

The OIG was also informed by the Interim Executive Director that there were no internal management reports being generated on a periodic basis or in a consistent manner to monitor the grantee's financial position and use of funds during the year.

### Response

Unfortunately, during your program visit, the former CFO who carried out the duties of internal management reporting and budgeting for the programs prior 30 years was not available for explanation as to budget formulations for 2010 and prior program years. During the former CFO's 30-year tenure with the program, reports were being generated on a periodic basis and in a consistent manner to monitor our financial position and use of funds throughout the year. It was not until 2010 when the former CFO decided to retire from the program permanently. At which time, no training was given to newly hired CFO's, to carry out the duties in a well managed manner.

Presently, AppalReD's Board feels that the needs for internal management reporting and budgeting are being met and well managed by its current administrative personnel. Personnel have been trained to oversee fund balances and monitor expenses and revenues for the entire program. The current accounting software used by the program allows entering of the approved Fiscal Year Budget which provides a complete analysis of current and upcoming expenses and revenues. These reports are being monitored and provided to key staff and Board on a regular basis.

The Board of Directors as approved a Budget for 2011 and has instructed that the Administration report to the Finance Committee of the Board monthly on the financial status of the firm. Additionally, monthly expense reports are being generated and shared with program managers.

### Employee Loan Programs

Our audit revealed significant deficiencies in the administration of the grantee's employee loan programs. The grantee has clearly defined written policies with respect to employee loans. In practice, many of the policies were not consistently followed. Specifically:

- The former Executive Director approved her own emergency loans without any board approval;

## Appalachian Research and Defense Fund of Kentucky RNO 618030

- Employees obtained new loans before fully paying back outstanding balances from previous loans;
- Justifications for the loans were inadequate and incomplete and not in accordance with grantee policy;
- No evidence of employees going to a credit union to get a loan as required by AppalReD policy;
- Loans were not paid back in accordance with loan agreements. (There was very little payback from July 2010 to December 2010. The accounting staff apparently did not understand how to set up the payroll deduction in the new accounting system.)
- Emergency loans were required to be secured by the employee's accrued vacation according to grantee policy, yet there was no written policy on disallowing employee use of accrued vacation if used to secure a loan.

### Response

AppalReD's Employee Loan Program has been discontinued by the Board until we've had adequate time to revise the procedures for disbursing such loans. In the meanwhile, all current outstanding loans have adequate loan documentation and payments are being automatically set up within the present accounting software to withhold those payments until the loans are paid in full.

### Vehicle Management Needs Improvement

At the time of our visit, AppalReD owned a fleet of 15 vehicles for employees to use to perform grantee business. However, the grantee does not have written policies on managing or disposing of vehicles. As a result, the grantee was paying car insurance on vehicles it no longer owned and on vehicles that were inoperable.

### Response

AppalReD's Board has established a Policies and Procedures Committee which is addressing the need for proper policies for vehicle management and disposal of vehicles for the program.

Car Insurance Premiums. Our review of the related car insurance policy revealed that the grantee paid car insurance on three vehicles for a number of years after the vehicles were disposed of and were no longer grantee vehicles. Also, at least two vehicles at the Prestonsburg, Kentucky office that were nonfunctional had car insurance premiums still being paid annually on those vehicles. Approximately 75 percent of the related car insurance expenses for these vehicles were charged to LSC funds.

The OIG is questioning \$13,186.24 of insurance costs paid for with LSC funds, during the period these vehicles were unnecessarily insured.

## Appalachian Research and Defense Fund of Kentucky RNO 618030

### Response

Program's monitoring of car insurance premiums for AppalReD's current fleet of 13 vehicles has been recently updated. Although two vehicles at the Prestonsburg, Kentucky Office location were nonfunctional and remained to be covered under the program's insurance policy, recommendation was made by the programs insurance carrier to maintain coverage on those vehicles until disposal as a result of the vehicles being stored in a public parking area.

Disposal of Vehicles. Also, the grantee does not have a policy or clearly established process on the disposal of vehicles that are no longer needed or inoperable.

### Response

AppalReD's Board of Directors is in the process of reviewing the necessity of procedures for disposal of vehicles within the program. A committee has been established and is currently involved in the creation of and implementation of these policies.

### Accounting Matters and Concerns

During our review of the grantee's accounting records, several accounting issues came to our attention.

Travel Advances. All eleven of the travel advances we reviewed were initially being recorded as an expense instead of as a receivable, even though some of the advances were made up to two months prior to date of travel. Also, there was no reconciliation of the expenses incurred after completion of travel to determine if any amount of the advance was due back to the grantee.

### Response

Travel advances provided by the program are based upon the current federal per diem rate and are provided to personnel for out-of-state travel. During the previous director's tenure, she did request these per diems nearly 2-months in advance of the planned travel. Although under the prior directorship these advances were made so far in advance of the travel, this is not the case under the current program leadership. The program's policies and procedures for Travel Advance requests are currently being followed and are being well documented and reconciled accordingly.

Accounting System Access. Access to the accounting system is not adequately controlled. Six individuals within AppalReD, of which two were former employees, had full access to the new SAGE accounting system to record, prepare, edit, disburse, and modify organization historl. The following individuals had that access:

1. The former ED
2. Interim ED
3. Accounting Contractor (Former CFO)
4. Interim CFO



## Appalachian Research and Defense Fund of Kentucky RNO 618030

5. Accountant
6. A/P purchasing clerk

These individuals make up the majority of the current accounting staff. As a result, the opportunity for malfeasance is high. The accounting system has ample capabilities to segregate incompatible duties through its activities permissions, but the current set up does not take advantage of this internal control feature.

### Response

All current Administrative Personnel have limited access to the program's accounting system. Due to the lack of knowledge of the set up operations during the initial installation of the software, some personnel may have been set up with full access by the SAGE program installer and trainer. As indicated in your report, the current accounting system has ample capabilities to segregate incompatible duties through its activities permissions and the system has been updated to assure the establishment of restrictions has been set in place.

Unrecorded Expenditures. The invoice for the new teleconferencing equipment was not entered into the accounting system as an accounts payable at the time of our on-site visit. The Interim ED indicated that it was due to insufficient funds to pay for the equipment. The cost of this equipment was approximately \$64,000 and was purchased in December 2010. As a result, any financial reports produced after the invoice was received may have been materially misstated. Also, we inquired about the supporting documentation for the new SAGE accounting system. We were not provided with a contract or the related invoices. Additionally, we were not able to trace the expenditure into the general ledger nor determine whether it was a legitimate cost allocable to LSC.

### Response

Currently, all financial obligations of the firm are recorded properly in the financial system and appropriate supporting documentation exists for all of these transactions. These records are being maintained within the current accounting software program and reflected on the program's financial reports.

### Unsupported Student Loan Reimbursement

AppalReD management developed and implemented a student loan assistance program outside of LSC's Loan Repayment Assistance Program (LRAP). Each participant is eligible for up to \$4,500 in assistance payments per year. There is no maximum amount per participant. A portion of the payments are charged to LSC basic field funds. At the time of the audit, approximately 20 staff members were receiving payments under this program. We examined 6 expenditures related to 4 of the 20 participants receiving reimbursements and found that agreements or adequate student loan documentation were not on file and could not be provided for review. As a result, it was unclear whether or not employees being awarded student loan assistance payments qualified under the AppalReD student loan assistance program.

## Appalachian Research and Defense Fund of Kentucky RNO 618030

The total amount paid out as Student loan reimbursements was \$115,849 over two years, with \$56,469 and \$59,380 being paid in FY2009 and FY2010, respectively. Because grantee management has not been enforcing its policies and obtaining appropriate supporting documentation, the OIG is questioning the portion of student loan assistance program payments charged to LSC amounting to approximately \$62,916 in FY2009 and FY2010 as unsupported costs.

### Response

Supporting documentation for each employee who participates in the Student Loan Reimbursement program exists within each individual's personnel file. Information as to the amount of outstanding loan principle is obtained every six-months from each individual. Loan reimbursement is closely monitored in accordance with the current Operating Guidelines for Student Loan Repayment Assistance Program. Also, current recipients of the student loan assistance are required to provide signed certification that during the previous six months, all the financial assistance received from AppalReD has been applied towards the total amount repaid. Staff are in place to assure the continued monitoring of this program benefit.

### Property Management

Our review of AppalReD's property indicated that the grantee has adequate practices in place to manage its property. However, the written policies documenting these practices are insufficient and need improvement. We compared the grantee's practices to LSC's Fundamental Criteria and found that the practices were generally in accordance with LSC requirements. However, we note that AppalReD's inventory listing did not include all the fields required by the LSC Accounting Guide for LSC Recipients. The inventory listing was missing the asset identification number and funding source fields. The fixed asset spreadsheet, which records all capitalized assets, was not updated timely with respect to additions or deletions and was only updated at year end. Also, the spreadsheet does not reflect on a timely basis transfers of assets between office locations.

### Response

AppalReD's Board agrees with LSC's recommendation to update its practices with regard to its property management. The current Policies and Procedures Committee will be reviewing the process by which property is managed by the program and will be updating and implementing these policies within the current year. AppalReD's inventory listing will be updated to include all the fields required by LSC's Accounting Guide for LSC Recipients. The fixed asset spreadsheet is being monitored on a regular basis and is being updated accordingly.

### Accounting Function and Organizational Structure

The current organizational structure needs to be evaluated and an adequate system designed with the related job duties and responsibilities clearly defined. The accounting department is currently going through transition and staffing levels need to be established. AppalReD currently has two former employees playing significant roles in the accounting function. These two



## Appalachian Research and Defense Fund of Kentucky RNO 618030

individuals are former AppalReD employees with a significant amount of operational experience in the accounting department. We were informed by the Interim EO that the two former employees are only temporary, and as such, their duties and responsibilities will have to be picked up by other accounting staff.

In addition, we requested job descriptions of the current staff in the accounting department. We were provided job descriptions, but were told by the Interim CFO that the job descriptions were out of date and did not truly represent the duties and responsibilities of the staff during our period of review. We were not provided with an explanation for why they were outdated. We also examined those job descriptions and determined that they did not adequately reflect the position, duties and responsibilities of the current accounting personnel. Accurate position descriptions helps ensure that employees with the right skills are hired for the right jobs and that those employees know their job responsibilities.

### Response

The overall accounting function and organization structure of AppalReD's current administrative personnel has changed drastically since the beginning of 2011. AppalReD's Board feels confident that the current staff are maintaining LSC's financial management requirements and have addressed and continue to address internal control and management needs as they arise. The current Policies and Procedures Committee is reviewing all personnel job descriptions and will be updating those for the entire program by the end of 2011. Meanwhile, administrative staff are performing individual functions as required to ensure internal controls within the programs fiscal management.