LSC

Legal Services Corporation
America's Partner For Equal Justice

Program Letter 10-2

TO: All LSC Program Directors

FROM: Victor M. Fortuno
President

DATE: July 1, 2010

SUBJECT: Embezzlement, Fraud, and the Critical Importance of Effective Internal Control

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Introduction

Recently there have been several incidents of embezzlement or alleged embezzlement by LSC grantee employees. In two cases, guilty pleas have been entered. One of the guilty pleas was from a former grantee executive director. The other guilty plea was from a grantee's former chief financial officer. In these two cases, a total of over $219,000 was embezzled from the grantees. In two other cases, criminal complaints have been filed against a former chief financial officer and a community worker alleging embezzlement of program funds in substantial amounts – one in excess of $1.1 million. Here are examples of some of the incidents and alleged incidents:

- **Inflated Prices Embezzlement** - A longtime trusted employee and a friend formed an office supply company with the program being the company's only client. The employee's department was in charge of administering the program's office supply purchasing agreement and prepaying for office supplies. When the program placed an order for office supplies the office supply company overcharged the program, the employee ensured the invoice was paid and the two men would skim the excess money.
- **Fictitious Clients Embezzlement** - A community worker fraudulently issued checks to friends of hers from the program's checking account. Her friends then cashed the checks and gave her half the money. The money was targeted for the homeless and was to be used to pay for security deposits and rent to keep clients from being evicted.

3333 K Street, NW 3rd Floor
Washington, DC 20007-3522
Phone 202.295.1500 Fax 202.337.6797
www.lsc.gov

- **Dual Accounting Systems Embezzlement** - A longtime trusted employee who worked in the program's accounting department managed to embezzle funds from the program by misusing the program's checkbook, credit card, and debit card. The program was running two parallel accounting systems while it was transitioning to a new system when one employee noticed a different year-end close-out balance. Upon further review it was revealed that the employee was writing checks made payable to herself in the old accounting system. Also, she used the program's credit card to pay personal bills along with other purchases. In addition, she made unauthorized cash withdrawals using the program's debit card.
- **Theft of Fees Paid by Clients Embezzlement** - Over a period of several years a program employee requested clients to provide cash or money orders to pay for Employment Authorization Documents (EAD). When the clients paid cash, the employee kept the cash; when the clients gave money orders the employee asked the client to leave the payee section of the money order blank and then cashed the money order.

We know that these acts of a very few members of LSC grantee staff do not represent the vast majority of staff who are highly dedicated and work tirelessly day-in-and-day out to deliver legal assistance to hundreds of thousands of eligible clients. Nonetheless, these acts of a few do serious damage to the legal services community, and even more importantly, our client communities. Improper management of financial resources or the failure to protect grant funds *at even one LSC grantee* has the potential for negatively impacting every grantee. Such incidents affect the credibility of programs in fundraising efforts and affect the perception that programs are well-run, efficient and effective organizations. Future funding by Congress, state legislatures and other funders, so very critical to the lives of poor people, also can be adversely affected.

The purpose of this compliance advisory is to provide guidance on those activities that help grantees implement effective systems of internal control for the proper use of grant funds. Executive directors and governing bodies have important leadership roles in communicating expectations regarding internal control throughout your program and providing ongoing monitoring of the control activities undertaken. While the possibility of embezzlement and other theft can never be eliminated completely, effective internal control can reduce the opportunity for unlawful acts and hasten the discovery of such acts should they occur. This advisory contains practical information on steps that can be taken to reduce your organization's vulnerability to embezzlement and fraud.

LSC strongly encourages grantees to use the guidance contained in this compliance advisory to review and reassess your program's financial operations and systems of internal control. It is also recommended that you seek the assistance of your independent public accountant in this effort.

Guidance

Every LSC grant is subject to LSC regulations and Grant Assurances that are signed by the governing body chairperson on behalf of the governing body and by the grantee executive director. These Grant Assurances require each grantee to use funds consistent with federal laws relating to the proper use of federal funds. (See 2010 LSC Grant Assurances No. 1 and 2; and 45 C.F.R. §1640.) Non-compliance with these requirements can result in questioned costs, additional special grant conditions, suspension of funding, termination of funding and even criminal charges against the individuals involved. Pursuant to these regulations and Grant Assurances, grantees are required to inform employees and governing body members of the federal laws and the consequences of a violation of the laws, both as to the grantee and as to themselves as individuals. (See 2010 LSC Grant Assurance No. 2; and 45 C.F.R. §1640.3.) This is an important notice requirement that attaches to LSC funding.

The LSC Accounting Guide has been revised recently and the 2010 edition will be released this summer. The Accounting Guide provides guidance on all aspects of fiscal operations. This Program Letter focuses specifically on provisions in the Accounting Guide related to internal control and fraud prevention and the recent changes to those sections.

LSC's Fiscal Advisory Group, consisting of the chief financial officers from eight LSC grantees and LSC staff, recognized the need to focus on and update the internal control sections of the Accounting Guide. A compilation of critical internal controls, with a listing of the key elements, criteria, aids in evaluating criteria and risks involved, is discussed in detail in the revised Fundamental Criteria section of the Accounting Guide. Section 3-5 contains accounting procedures and internal controls to be used, at a minimum, as guidelines by grantees' management in developing or improving accounting systems and internal control procedures. New sections on Electronic Banking and Contracting are now included in the Accounting Guide. The revised Fundamental Criteria also contain sections on Control, Roles and Responsibilities, Annual Financial Statements and Audit Reports, Cash Receipts, Cash Disbursements, Payroll, General Journal, Client Trust Records, General Ledger, Management Reports, Budgeting, and EDP.

The new Accounting Guide has a significantly revised internal control checklist that provides guidance to programs on how accounting procedures and internal control can be strengthened and improved with the goal of eliminating, or at least reducing as much as reasonably possible, opportunities for fraudulent activities to occur. *See Attachment A.* There is also a new section in the Accounting Guide on fraud prevention. The fraud prevention section contains a list of 26 key practices in which a grantee can engage to help prevent opportunities for embezzlement and fraud. *See Attachment B.*

In addition to the guidance in the new Accounting Guide, the grantee's independent public accountant and specialized financial internal control training, there are other resources that programs can and should draw upon to help prevent opportunities for embezzlement and fraud. These include resources available through:

- American Institute of Certified Public Accountants - materials concerning internal control (www.aicpa.org)
- BoardSource - materials concerning board oversight and internal control (www.boardsource.org)
- LSC Office of Inspector General (www.oig.lsc.gov) and OIG issued fraud alerts (www.oig.lsc.gov/fraud/fraud.htm#top)

LSC-funded programs strive to be vigilant guardians of both public and private funds with which they are entrusted. The importance of effective internal control to help prevent opportunities for embezzlement and fraud cannot be overstated. We know that each of you join with LSC in concern about any improper use or theft of LSC grant funds.

Thank you for your attention to the important issues raised in this compliance advisory. Our combined efforts and our continuing commitment to effective internal control will help reduce opportunities for unlawful acts and hasten the discovery of such acts should they occur. By doing so, we continue to make our limited grant funds reach as many persons as possible in our quest to ensure access to justice.

ATTACHMENT A

(Excerpt from Accounting Guide for LSC Recipients – 2010 Edition)

APPENDIX VII ACCOUNTING PROCEDURES AND INTERNAL CONTROL CHECKLIST

The essence of an effective system of internal control is the segregation of duties in such a way that the persons responsible for the custody of assets and conduct of operations have no part in the keeping of, and do not have access to, the records which establish accounting control over the assets and the operations. Duties of individuals should be so divided as to minimize the possibility of collusion, perpetration of irregularities, and falsification of the accounts. The objective is to provide the maximum safeguards practicable in the circumstances, giving due consideration to the risks involved and the cost of maintaining the controls.

The following checklist is provided as a guideline for recipient's management to direct attention to practicable revisions of accounting procedures or internal controls which can be made to strengthen, improve, or simplify the existing system. This checklist should not be considered all-inclusive nor are all items considered necessary for all recipients. This is an area where recipients should utilize the expertise of their auditors in a continuing relationship to maximize the services an auditor can provide.

A. GENERAL

1. Has a system of authorizations and approval been established to require appropriate managerial approval for all significant actions or financial transactions of the organization?

2. Has a chart of accounts been established which reflects all revenue sources, all categories of expenses, as well as all assets, liabilities and any contra accounts[1] .i.e., accumulated depreciation, to be utilized in the accounting system?

3. Does the organization use a double-entry accounting system and a trial balance?

[1] A "contra account" is a balance sheet account with a balance that is opposite (contra) to normal accounts in that category. For example, an Allowance for Doubtful Accounts within Accounts Receivable would be a contra account. Some other examples would be a Purchase Discounts or a Purchase Returns and Allowances account which would be contra accounts to Purchases; or an Accumulated Amortization account which would be a contra asset account crediting the Amortization account and off-setting the debit position.

4. Are transactions in the accounting records properly authorized, as evidenced by supporting documentation containing the appropriate approving official's signature?

5. Are bank accounts and persons who sign checks authorized by the governing body?

6. Are employees and officers who handle assets or perform significant financial duties bonded as required by 45 CFR § 1629?

7. Does the recipient prepare and its Board approve an annual overall financial plan or operating budget to allocate its resources and provide a system of evaluation and control?

8. Are budget controls established and regular periodic financial reports reflecting actual revenue and expense compared to the approved budget generated which would allow the program director to adequately control expenditures?

9. Are procedures established to provide a clean cutoff between accounting periods with respect to the recording of revenue and expenses?

10. Has a general policy with respect to insurance coverage been defined and procedures instituted to insure that all significant business risks have been covered? Is insurance coverage periodically reviewed with a competent insurance agent?

11. Are adjusting journal entries adequately explained, supported, and approved by a responsible officer or employee?

12. Does the recipient have an accounting and financial manual that defines current processes used to meet LSC and other grant requirements and Financial Accounting Standards Board (FASB) standards?

13. Is there an organization chart to show definite lines of responsibility and authority?

14. Are employees required to take annual vacations, and are duties assigned to others in the absence of an employee on vacation or otherwise absent?

15. Are the accounting policies followed by the organization in agreement with those stipulated by their grants and contracts?

16. Where feasible, are costs accumulated into cost pools for later allocation of costs to each project, contract, and grant?

17. Is the method used to allocate indirect or common cost pools equitable and approved by the various funding organizations if required?

18. Is there a Cash Flow Statement to assure that adequate cash is available for the program to operate? Is a statement of cash on hand or a Cash Flow Statement submitted monthly to the Finance Committee of the Board of Directors and quarterly to all Board members?

19. With limited exceptions as described in the LSC Accounting Manual, are all cash accounts held in financial institutions which are federally insured and are limited to the maximum insured limits or do bank institutions provide securities pledge for cash over the allowable FDIC amount?

20. Is there a board-approved policy that salary advances will be made in very limited, very specific circumstances or that no salary advances will be made under any circumstances?

21. Are two signatures required for all disbursements above a specific amount?

22. Are all funds received segregated by source and purpose into separate accounts in the general ledger to avoid any possibility of commingling grant funds? Are monthly financial statements including Balance Sheet and Statement of Revenues and Expenses being produced and submitted monthly to the Financial Committee; quarterly to Board of Directors?

23. Are the services of an Independent Certified Public Accountant engaged to conduct a formal financial audit for fiscal year-end?

24. Does fiscal staff receive periodic training?

B. PERSONNEL AND PAYROLL

1. Are salary and wage rates approved by a responsible manager in writing and are procedures adequate to provide that employees are paid in accordance with approved budget, wage, or salary rates?

2. Do procedures provide for the proper withholding and payment of applicable federal, state, and local income and payroll taxes and other voluntary employee deductions?

3. Are employees furnished information as to their earnings, deductions from earnings, leave accrued, used and balance, etc.?

4. When employees are initially hired, do procedures provide for reference checks and employment data, and is documentation made of these procedures and maintained as part of the employees' files?

5. If direct deposit is not used, are payroll checks signed by persons having no part in preparing the payroll or if signed by machine, has management reviewed and initialed the payroll register?

6. Are there written personnel policies prohibiting employment of individuals which could result in nepotism or conflict of interest?

7. Are the payroll bank accounts reconciled by employees who have no other functions with respect to the payrolls?

8. Do procedures followed in reconciling payroll bank accounts include the checking of names on pay checks against payroll records and the examination of endorsements on checks?

9. Is the reconciliation reviewed each month and signed by an officer or responsible employee?

10. Is a review of each payroll done before processing to verify hours, rates, or other bases of payment by reference to attendance records, employment authorizations, approved rate changes, etc. by someone not connected with preparation or distribution of the payroll?

11. Are personnel policies established in writing?

12. Are employees' timesheets or reports of hours worked approved by the employees' supervisor for payroll purposes?

13. Are records kept on personnel actions including hiring, promotion, performance evaluation, dismissal, and resignation of both full-time and part-time employees?

14. Is there a copy of the organization's nondiscrimination policy, signed by the employee, in each personnel file?

15. Are labor hours charged (distributed) to projects, contracts, and grants based on time distribution records, which identify the total time actually spent by all individuals who charged time directly to projects, contracts, and grants?

16. Are payroll totals checked against labor distribution totals which are compiled from the original time records and are explanations provided for any variances where necessary?

17. Are payrolls disbursed from an imprest bank account restricted for that purpose and/or are the related bank transactions being reviewed periodically online?

18. Do the personnel and/or payroll records include the following or similar records:
    a. An attendance record?
    b. Vacation, sick and other excused leave records?
    c. Individual payroll record form?
    d. A payroll register?
    e. Notification concerning appointments, terminations, position classifications, and salary rates?
    f. A job description?

19. When employees work overtime, are there procedures to provide for (where applicable):
    a. Authorizing and paying overtime only to employees entitled to receive overtime pay?
    b. Recording earned and used compensatory time in lieu of overtime pay?

20. Where duties require employees to spend time away from their offices, do they disclose their weekly or monthly activities?

21. Are duties of those preparing the payroll rotated?

22. Is a "tax return calendar" or other method used to insure timely preparation and filing of various payroll tax returns and are the returns reviewed?

23. When payroll checks are not direct deposited, is the payroll delivered and checks reviewed by someone other than the payroll preparer? If in-house, is the person distributing the payroll checks different from the preparer?

24. Are the printed and computer Payroll and Personnel files (including benefits) locked or password protected and are the passwords in a secure location with limited access? Is the preparer's computer screen hidden from public view and does it automatically go to a password protected screen saver after a few minutes of inactivity?

25. If payroll is done in-house, are all checks pre-numbered and kept in a log listing any manual, spoiled or voided checks and is the log reviewed and initialed by management or other responsible party not related to the payroll process?

26. Are payroll processing procedures in writing and included in the Accounting Manual?

C. PROPERTY CONTROL

1. Are records maintained for fixed assets purchased in excess of $5000 which provide the following information:
   a. Date of purchase?
   b. Description of item, including model and serial number?
   c. Cost and salvage value, if any, of item and check number of disbursement?
   d. Identification of funds used to purchase assets?
   e. Depreciation lives assigned to assets?
   f. Identification number and location of asset?

2. Are fixed-asset records for items with a cost in excess of the capitalization limit balanced to the general ledger control accounts periodically?

3. Are fixed assets tagged for easy identification with fixed asset records?

4. Are physical inventories taken at least once every two years and compared to fixed asset records?

5. Are adjustments (including adjustments resulting from theft, retirement and sale of assets) to fixed-asset records and general ledger control accounts reviewed and approved by an appropriate organization employee or officer who does not have responsibility for maintaining fixed-asset records?

D. PROCUREMENT

1. Are supplies in storage reasonably protected from theft, deterioration and damage?

2. Do procedures provide for the solicitation of prices for purchase, rent, and/or lease of fixed assets?

3. Do procedures provide that consideration will be given to the cost advantages of buying versus renting equipment and other nonexpendable property?

4. Are approved vendor lists used for recurring purchases?

5. Does the recipient have a systematic method for determining what supplies are needed and in what quantities?

6. Are pre-numbered purchase orders used and appropriate authorization

obtained prior to purchase, rent, or lease of equipment and supplies?

7. Are receiving documents prepared (e.g., receiving log or ticket) and inspection of goods made without reference to purchase orders?

8. Are invoices, purchase orders and receiving documents compared and accounted for by a person not having any other purchase or receiving functions?

9. Are purchase orders outstanding for long periods of time investigated?

10. Has prior approval from LSC been requested for purchases with LSC funds of real property, purchases or leases of personal property with a value of over $10,000 and capital expenditures of more than $10,000 to improve real property?

11. Do procedures provide for the solicitation of proposals or bids prior to entering into a contract that exceeds a specified dollar amount? Are these procedures consistent with the LSC Property Acquisition and Management Manual (66 Fed. Reg. 47695) when LSC funds are used?

12. Is each purchase, above a reasonable level, fully documented by maintaining the bids received and the approvals given? In the event there is a sole source purchase above a specified dollar amount, is there written justification for such purchase?

E. LEGAL CONSULTANTS/CONTRACT SERVICES

1. Are there adequate procedures to insure that the governing body (or other authority) and all necessary funding source approvals are obtained prior to entering into contracts?

2. Are contracts written so that the services to be rendered are clearly defined? Are contracts properly signed by authorized persons? Have all contract terms and modifications been complied with?

3. Are contract costs monitored to ensure that they are incurred within the appropriate fiscal year and do not exceed budget authority?

4. Are modifications to an existing contract made in writing and are future obligations adjusted to reflect the new contract?

F. TRAVEL

1. Does the organization have formal written travel policies including policies

regarding travel requiring prior approval?

2. Is adequate information and documentation (e.g., lodging receipts, air fare tickets) received from an employee and board member before reimbursement for travel expenses is made?

3. Are there adequate controls over the accounting for advances and reimbursements for travel expenses made to employees and board members?

4. For out-of-town travel, do employees and board members prepare trip reports documenting the reasons and/or the results of the trip?

5. Do travel reimbursement requests require documentation of the reason for the travel to ensure proper funding source accounting?

6. Before making travel reimbursement payments, does the accounting office review the prior payment to the employee or board member in order to avoid duplicate payments for the same expense?

G. CONTROLS OVER CASH DISBURSEMENTS – All Transactions

In the past when discussing cash disbursements, the focus was almost exclusively on how checks were processed. With current technology, today's cash disbursements may occur in a variety of ways, and may include the following in addition to traditional checks:

- Automatic and recurring bank withdrawals
- Telephone transfers
- Online Bill Pay options
- Internet/Web-based initiated transactions
- Wire Transfers (such as inter account transfers)
- Credit/Debit Card Payments

Whatever the method used, the end result is the same as if a check were written, funds will be withdrawn from your program's bank account. While the above options can be more convenient and save your staff time in making payments, accounting for and maintaining proper internal control can be a challenge. Recommendations that apply to all methods of cash disbursements follow:

1. Has your program's governing body addressed the issues of what disbursement methods are allowed, who is authorized to initiate them, what documentation needs to accompany the disbursements, and most importantly, which INDEPENDENT persons will REGULARLY & CONSISTENTLY review the supporting documentation?

2. Are independent, authorized signors logging into the program's bank account(s) on a regular basis, to review the variety of disbursement methods used to withdraw cash? *Logging in daily only takes 5 minutes, and goes a long way towards protecting program assets and strengthening internal control.*

3. When disbursements (except payroll) are presented to authorized signors for review, are the supporting vouchers and invoices also presented?

4. Are there appropriate controls to assure that payments are made only for allowable items of costs, as defined by the terms of the respective contracts and grants?

5. Are written accounting policies and procedures established to describe the accounting system and assure that similar transactions are processed consistently?

6. Is there an appropriate system for filing checks, check copies, non-check disbursements, and supporting documents; and are supporting documents filed in such a manner so as to be readily located?

7. Are supporting documents marked paid or otherwise canceled and the check number, or other method of payment, and date of payment indicated to prevent duplicate payments?

G1. CONTROLS OVER CASH DISBURSEMENTS – Checks

1. Are all checks pre-numbered?

2. Are there procedures to insure that checks are never drawn payable to:
   a. Officers or employees with the understanding that the cash is to be used for organization purposes (other than for payroll, travel reimbursements, petty cash reimbursements, etc.)?
   b. Cash, bearer, or similar payee which renders the check payable to bearer?
   c. Other payee when the payee named is not intended as the party to retain the funds?

3. Are there procedures to insure that blank checks are never signed in advance?

4. Have there been procedures adopted to insure that the names of individuals once authorized as check signers are not retained in the signature lists on file with the banks after the individuals have left the employ of the recipient or have been transferred to duties incompatible with check signing?

5. Where a mechanical check signer is used, is the signature dye under adequate control?

6. Is a check protector used when necessary?

7. Are voided or damaged checks entered in the General Ledger as VOID, marked VOID or defaced in a manner that would prevent future use of the check, and are the checks retained and filed (in a void check file or in sequence with canceled checks)?

8. Do checks presented to a check signer for approval and signature include documentation supporting the expense?

G2. CONTROLS OVER CASH DISBURSEMENTS – Electronic Transactions

1. Has a password protected file been created to store user names and passwords used to access accounts and websites where disbursements can be initiated, and is this file accessible to authorized users only?

2. Are on-line banking passwords required to be changed periodically?

3. Have procedures been adopted to ensure that the names of individuals who have left employment or have been transferred to incompatible duties, have been removed from access to on-line, web-based accounts where disbursements can be initiated, or have the usernames and passwords been changed so they no longer have access?

4. Before initiating online transactions, has the balance of the bank account from which funds will be withdrawn been verified to contain sufficient funds?

5. If regular, recurring automatic bank account withdrawals are occurring, have you set up repeating batches in your accounting system, to anticipate cash flow needs, and to properly record the transaction in a timely manner?

6. Is a listing of the organization's regular online banking activities maintained for its regular electronic depositors and approved electronic vendors?

G3. CONTROLS OVER CASH DISBURSEMENTS – Credit/Debit Cards

1. Is personal use prohibited regardless of the fact that the employee is an authorized user?

2. Has your program considered setting a maximum dollar amount that can be charged, before prior authorization from an independent manager must be approved?

3. Are all cash advances or ATM withdrawals disallowed as program policy?

4. Does your program have a written policy as to how soon receipts need to be turned in?

5. Are procedures in place to insure that access is denied and the credit/debit card is returned by terminating employees, or those employees who are transferred to positions incompatible with the use of the credit/debit card?

6. Is there timely review and payment of credit/debit/vendor charge account transactions & supporting documentation, to validate disbursements and to avoid finance charges and late fees?

7. Have you developed a policy, that any personal and/or disallowed charges may be deducted from the employee's paycheck?

8. Have you developed a form that contains the above policies for your employees to review and sign off on?

H. CONTROLS OVER CASH RECEIPTS

1. Are cash receipts deposited currently and intact?

2. Does the accounting system identify the receipt and expenditure of program funds separately for each contract and grant requiring separate reporting?

3. Are bank-stamped duplicate deposit slips compared with the Cash Receipts Journal?

4. Does the employee who opens the mail list the receipts in detail in the cash receipts log and is this record used by someone independent of other accounting functions to verify the amount recorded in the general ledger and deposited in the bank?

5. Does the employee opening the mail, stamp "for deposit only payable to [program name]"on the back of checks received?

6. Is documentation which supports the funding source credited, saved with the deposit information?

7. In addition to manual deposits, automatic deposits, interest credited, and wired funds transactions may occur, are staff responsible for reviewing and recording these logging in with an authorized username and password, to regularly review and record these transactions?

8. Are there procedures to ensure that cash received in the office is properly handled?

9. Is there an employee(s) who is specifically authorized to receive cash?

10. Is a receipt provided to the person paying the cash, with a duplicate receipt maintained by the program?

11. Is a cash receipts log maintained?

12. Are there procedures to ensure that cash receipts are not commingled with the petty cash fund?

13. Are cash receipts promptly deposited in a program bank account?

14. Is there a procedure to reconcile cash receipts with the receipt log on a frequent basis?

15. Is there notice to clients about the program's cash receipts policy? Does the notice state that the client is entitled to a receipt for cash provided and if a receipt is not provided that the client should see a supervisor?

16. Is there a policy to require all checks and money orders received to be restrictively endorsed?

I. BANK RECONCILIATION PROCEDURES

1. Are bank accounts reconciled monthly?

2. Does the reconciliation procedure include:

   a. Comparison of checks with check register as to number, date, payee, and amount?

   b. Examination of signatures and endorsements, and procedures for the return of inadequately endorsed checks, paid by banks, to the banks for proper endorsements?

   c. Examination of voided checks?

d. Accounting for serial numbers of checks?

e. Comparison of dates and amounts of daily deposits as shown by the cash receipts records with the bank statements?

f. Test-check of details shown on authenticated duplicate deposit slips obtained directly from the banks against the corresponding details in the cash receipts records?

3. Are proper journal entries made in the general ledger and check register for voided checks?

4. Are bank statements reconciled with the respective general ledger cash account?

5. Are bank accounts monitored during the month for wire transfers?

6. Are completed bank reconciliations reviewed by the Fiscal Manager and initialed?

7. Are checks which have been outstanding for more than six months investigated and resolved?

8. Are bank statements delivered unopened directly to the person preparing the reconciliation or management official for review prior to the reconciliation?

J. SEGREGATION OF DUTIES

1. Do the bookkeeper's duties exclude the following functions:
   a. Receive cash or checks?
   b. Open the incoming mail?
   c. Prepare bank deposits?
   d. Sign checks?

2. Does an individual other than the person who prepares the bank deposit slip actually deposit the cash in the bank and are the bank-endorsed deposit slips reviewed upon return from the bank?

3. Is the mail opened by a person who does not prepare the bank deposit?

4. Do the duties of the person preparing the bank reconciliation exclude:

   a. Posting to the books of account?
   b. Handling cash?

c. Signing checks?

5. Are checks, after being signed, controlled and mailed out by an individual who does not have any other payables duties?

K. PETTY CASH CONTROLS

1. Is there a board-approved petty cash policy?

2. Is responsibility for the petty cash fund vested in only one person per office/cash box?

3. Are petty cash vouchers:
   a. Required for each petty cash disbursement?
   b. Signed by the recipient of the cash disbursed?
   c. Executed in ink?
   d. Approved by a responsible person?

4. Are there restrictions on petty cash (that is, what it can be use for and maximum amount for each disbursement)?

5. Are petty cash disbursements evidenced by properly approved supporting data?

6. Are supporting data for petty cash disbursements checked at time of reimbursement?

7. Are petty cash reimbursements made payable directly to the petty cash custodian by name rather than to cash, bearer, etc.?

8. Are petty cash funds maintained on an imprest basis?

9. Are there procedures to insure that the cash receipts are not commingled with the petty cash fund?

10. When the petty cash fund is reimbursed, is a notation of payment made on supporting data to prevent duplicate payment?

11. Is there a policy to deal with overages/shortages/losses?

12. Is the petty cash bank account reconciled by an employee independent of the petty cash custodian?

13. Are petty cash funds audited by surprise counts by an independent person to insure the fund does not include personal checks, IOU's, etc., and that the petty cash fund balances? Is this part of the program's annual audit?

14. Are there procedures regarding access to and physical control over the petty cash box during and after work hours?

L. CLIENT TRUST ACCOUNTS

1. Are client funds deposited into a bank account used only for the client's intended purpose?

2. Was the client trust bank account approved by the governing body?

3. Are two signatures required on checks?

4. Is the account reconciled by an individual not involved with client deposit operations?

5. Are pre-numbered receipts given to clients for all checks and cash received?

6. Are the following records maintained for the accounts?

   a. A receipts book with pre-numbered receipts.

   b. A cash disbursements journal.

   c. A detailed record of the activity for each client's deposit.

7. After several documented attempts to locate the client, are unclaimed client funds timely turned over to the state unclaimed funds account pursuant to state law?

M. ELECTRONIC BANKING

1. Does the organization have documented processes and procedures for its electronic banking activities including policies for: electronic deposits, wire transfers, on-line transfers, telephone transfers and electronic disbursements?

2. Are electronic banking activities understood and authorized by management?

3. Is a listing of the organization's regular online banking activities maintained for its regular electronic depositors and approved electronic vendors?

4. Are employees that initiate and transmit electronic transactions appropriately and specifically authorized to do so by management or the board?

5. Are electronic transactions timely reviewed and approved by someone other than the person initiating the transactions?

6. Are the bank accounts reconciled by someone who does not initiate electronic transactions?

7. Is the electronic activity posted to the general ledger by someone who does not initiate the electronic transactions?

8. Are employees with access to on-line banking software appropriately authorized?

9. Are on-line banking software users and privileges reviewed periodically?

10. Is on-line banking software access secure and monitored?

11. Are on-line banking passwords required to be changed periodically?

12. Are electronic transactions supported by adequate supporting documentation?

13. Are procedures in place to assure that electronic transactions are recorded to the proper fund or account?

14. Is access to the organization's payroll software authorized, controlled and secure?

15. Are payroll activities for electronic direct deposits regularly reviewed by an employee other than the person that prepares the payroll?

16. Are payroll activities including automatic electronic transactions processed using a designated payroll bank account that is separate from the organization's general bank account?

17. Has the organization researched and implemented banking safeguards and features that may be available with its banking institution?

ATTACHMENT B

(Excerpt from Accounting Guide for LSC Recipients – 2010 Edition)

Chapter 3-6 FRAUD PREVENTION

The following key practices can help prevent fraud upon a grantee. This is not intended to be a complete list, and grantees may develop other thoughtful fraud prevention approaches not mentioned below.

1. Practice reasonable segregation of duties.
2. Reconcile bank accounts promptly.
3. Reconcile GL accounts promptly.
4. Keep accounting and personnel policies and procedures current.
5. Provide adequate employee training.
6. Control access to check stock, on-line banking software, accounting software and payroll software.
7. Do not share passwords.
8. Do not allow unauthorized software to be installed on business computers.
9. Limit access to financial records.
10. Limit credit card users and set credit card spending limits.
11. Maintain limited balance bank accounts for certain activities.
12. Assign permissions and authorizations deliberately and only as needed.
13. Change passwords and access codes periodically.
14. Delete old passwords and users immediately.
15. Have thorough and well documented hiring practices and procedures.
16. Employ strict office security policies and procedures.
17. Take advantage of bank services such as e-mail notifications for certain transaction, positive pay services, ACH filters, blocks on certain

transactions, on-line banking features and on-line credit card account review features.

18. Make sure your computer network has robust and updated security processes, firewalls, anti-virus protection, spyware protection and other intrusion detection software.

19. Have a "Whistleblower Policy" in place that provides assurances that retaliation will not occur when an employee, board member or volunteer reports suspected fraud.

20. Have a "Conflict of Interest Policy" in place for management and the board of directors.

21. Remind and refer employees to the state bar association's professional ethics requirements, applicable federal and state laws and the organization's code of conduct, at least once per year.

22. Remind board members that the applicable federal and state laws also apply to them. 45 CFR § 1640.3 "Contractual Agreement" requires the following:

    > As a condition of receiving LSC funds, a recipient must enter into a written contractual agreement with the Corporation that, with respect to its LSC funds, it will be subject to Federal laws listed in § 1640.2(a)(1). The agreement shall include a statement that all of the recipient's employees and board members have been informed of such Federal law and the consequences of a violation of such law, both to the recipient and to themselves as individuals.

23. Have well defined expense reimbursement policies and strict expense documentation requirements.

24. Involve the board and executive management in internal control policies and oversight efforts.

25. Promptly follow-up on any internal control findings, discrepancies, issues, weaknesses, comments or suggestions from internal auditors, external auditors, government agencies, employees, grantors or others.

26. Have a policy for what to do if you uncover fraud. When fraud is suspected or discovered a recipient is required to:

Notify the LSC Office of Inspector General (OIG) Hotline (Telephone: 800-678-8868 or 202-295-1670; E-mail hotline@oig.lsc.gov; Fax 202-337-7155) within two (2) work days of the discovery of any information that gives it reason to believe it has been the victim of a loss of $200 or more as a result of any crime, fraud, misappropriation, embezzlement, or theft involving property, client funds, LSC funds, as well as non-LSC funds used for the provision of legal assistance; or when local, state, or federal law enforcement officials are contacted by the program about a crime. It also will notify the OIG if it has been the victim of a theft of items such as credit cards, check stock, passwords, or electronic access codes that could lead to a loss of $200 or more. The required notice shall be provided regardless of whether the funds or property are recovered. Once it has determined that a reportable event has occurred, it agrees it will contact the OIG before conducting its own investigation into the occurrence. (Refer to the LSC Grant Assurances for any update to this requirement.)