

August 2007

LEGAL SERVICES
CORPORATION

Governance and
Accountability
Practices Need to Be
Modernized and
Strengthened





Highlights of [GAO-07-993](#), a report to congressional requesters

Why GAO Did This Study

The Legal Services Corporation (LSC) was federally created as a private nonprofit corporation to support legal assistance for low-income people to resolve their civil matters and relies heavily on federal appropriations. Due to its unique status, its governance and accountability requirements differ from those of federal entities and nonprofits. This report responds to a congressional request that GAO review LSC board oversight of LSC's operations and whether LSC has sufficient governance and accountability. GAO's report objectives are to (1) compare LSC's framework for corporate governance and accountability to others', (2) evaluate LSC's governance practices, and (3) evaluate LSC's internal control and financial reporting practices. We reviewed the LSC Act, legislative history, relevant standards and requirements, and LSC documentation and accountability requirements and interviewed board and staff.

What GAO Recommends

Congress should consider mandating additional LSC governance and accountability requirements modeled after federal agencies or government corporations. GAO also makes recommendations to LSC's board for modernizing and strengthening its governance and to LSC management for improving its practices. LSC's board and management agreed with the recommendations.

www.gao.gov/cgi-bin/getrpt?GAO-07-993.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Jeanette Franzel at (202) 512-9471 or franzelj@gao.gov.

LEGAL SERVICES CORPORATION

Governance and Accountability Practices Need to Be Modernized and Strengthened

What GAO Found

Although LSC has stronger federal accountability requirements than many nonprofit corporations, it is subject to governance and accountability requirements that are weaker than those of independent federal agencies and U.S. government corporations. Congress issued LSC's federal charter over 30 years ago. Established with governance and accountability requirements as they existed at the time, LSC has not kept up with evolving reforms aimed at strengthening internal control over an organization's financial reporting process and systems. Rigorous controls are important for the heavily federally funded LSC. During fiscal year 2007, LSC is responsible for the safeguarding and stewardship of \$348.6 million of taxpayer dollars. Although no single set of practices exists for both private and public entities, current accepted practices of federal agencies, government corporations, and nonprofit corporations offer models for strengthening LSC's governance and accountability, including effective board oversight of management; its performance; and its use of federal funds and resources.

The board members demonstrated active involvement in LSC through their regular board meeting attendance and participation in LSC oversight. Although LSC's Board of Directors was established with provisions in law that may have supported effective operation over 30 years ago, its practices fall short of modern board practices. The LSC board generally provides each new member an informal orientation to LSC and the board, but it does not have consistent, formal orientation and ongoing training with updates on new developments in governance and accountability standards and practice. The current board has four committees, but none are specifically targeted at providing critical audit, ethics, or compensation functions, which are important governance mechanisms commonly used in corporate governance structures. Because it has not taken advantage of opportunities to incorporate such practices, LSC's Board of Directors is at risk of not being able to fulfill its role of effective governance and oversight. A properly implemented governance and accountability structure may have prevented recent incidents of compensation rates in excess of statutory caps, questionable expenditures, and potential conflicts of interest.

LSC also has not kept up with current management practices. Of particular importance are key processes in risk assessment, internal control, and financial reporting. Management has not formally assessed the risks to the safeguarding of its assets and maintaining the effectiveness and efficiency of its operation, nor has it implemented internal controls or other risk mitigation policies. LSC is also at increased risk that conflicts of interest will occur and not be identified because senior management has not established comprehensive policies or procedures regarding ethical issues that are aimed at identifying potential conflicts and taking appropriate actions to prevent them. Finally, management has not performed its own assessment or analysis of accounting standards to determine the most appropriate standards for LSC to follow.

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United States Government Accountability Office
Washington, DC 20548

August 15, 2007

Congressional Requesters

The Legal Services Corporation's (LSC) mission is to make federal funding available to support the provision of legal assistance in civil matters to low-income people throughout the United States on everyday legal problems. LSC pursues this mission by making grants¹ to legal service providers (grant recipients) who serve low-income members of the community who would otherwise not be able to afford legal assistance (clients). Established by a federal charter² in 1974³ as a federally funded, private nonprofit corporation, LSC is highly dependent on federal appropriations for its operations. LSC received \$348.6 million in appropriations for fiscal year 2007.⁴ For fiscal year 2006, LSC received 99 percent of its funding from federal appropriations and approximately 1 percent from grants through the Department of Veterans Affairs.

This report responds to your request that we review how LSC's Board of Directors has been carrying out its fiduciary duties⁵ in overseeing LSC's operations and use of appropriated funds and whether LSC has sufficient

¹As used in this report, the term grant encompasses all of the agreements LSC uses to distribute federal funding to providers of civil legal assistance to low-income persons, and the term grant recipient refers to those who enter into such agreements. Although LSC distributes most financial assistance through grants, it sometimes uses contracts.

²As used in this report, the term federal charter refers to a congressional act, or the written instrument documenting this act as in a statute, that establishes or authorizes the establishment of a corporation and includes requirements governing the corporation's operations.

³Legal Services Corporation Act of 1974, Pub. L. No. 93-355, 88 Stat. 378 (July 25, 1974), *codified, as amended, at* 42 U.S.C. §§ 2996 – 2996I (LSC Act).

⁴Revised Continuing Appropriations Resolution, Pub. L. No. 110-5, 121 Stat. 8, 44 (Feb. 15, 2007); *see also* the LSC appropriations act for fiscal year 2006, Pub. L. No. 109-108, 119 Stat. 2290, 2330 (Nov. 22, 2005).

⁵The highest standard of duty implied by law, a fiduciary duty is a duty imposed by law on a person in a position of trust to act for someone else's benefit and not to further one's personal interests. As a corporate board member, this means a duty to use a high level of care to manage the corporation to best promote the corporation's interests. *See, e.g., Friends of Tilden Park, Inc. v. District of Columbia*, 806 A.2d 1201, 1210 (App. D.C. 2002).

governance and accountability structures and practices in place. The specific objectives of this report are to (1) compare LSC's statutory framework for corporate governance and accountability to those of other organizations; (2) evaluate the governance practices that LSC has adopted, including the board's operations and responsibilities; and (3) evaluate LSC's internal control and financial reporting practices in comparison to current practices of other organizations.

To address these objectives, we reviewed information from a variety of sources, including the Legal Services Corporation Act of 1974 (LSC Act) and LSC annual appropriations acts; the LSC Act's legislative history, relevant legislative and regulatory standards and requirements for financial reporting and internal control, and research and studies on corporate governance. We compared LSC's governance, accountability, and oversight requirements with those for independent federal agencies headed by a board or commission, U.S. government corporations,⁶ and D.C. nonprofit corporations, including the Corporation for Public Broadcasting (CPB), which, like LSC, was established by Congress and receives federal appropriations. To obtain information on the current policies and practices of LSC and its Board of Directors, we interviewed current members of LSC's board, management, and staff, and staff in LSC's Office of the Inspector General (OIG) and the audit firm the OIG employs. We also reviewed relevant documentation of the design and implementation of LSC's and the LSC board's governance and accountability practices and conducted a survey of all board members.

We conducted our work in Washington, D.C., from November 2006 through June 2007 in accordance with generally accepted government auditing standards.

Results in Brief

In recent years, governance and accountability processes have received increased scrutiny and emphasis in the nonprofit, federal government, and public company sectors as a result of governance and accountability breakdowns, most notably in the public company financial scandals that

⁶Unless otherwise noted, we use the term U.S. government corporation to refer to those corporations subject to Chapter 91 of the U.S. Code (commonly known as the Government Corporation Control Act). See 31 U.S.C. § 9101 for the list, which includes both wholly owned and mixed-ownership government corporations.

led to the enactment of the Sarbanes-Oxley Act of 2002. Public companies⁷ now operate under strengthened governance and accountability standards, including requirements for ethics policies and improved internal controls. The federal government and nonprofit sectors have also strengthened governance and internal control requirements and practices. As a result, commonly accepted governance, accountability, and management practices for federal entities and nonprofit corporations have significantly evolved in recent years. LSC's authorizing legislation was last comprehensively reviewed and reauthorized in the Legal Services Corporation Amendments Act of 1977, and LSC's governing statutes have undergone only limited changes since then.

Although LSC has stronger federal accountability requirements than many nonprofit corporations, it is subject to governance and accountability requirements that are weaker than those of independent federal agencies headed by boards or commissions and those of U.S. government corporations. The LSC Act includes provisions providing that LSC shall be treated like a federal agency for purposes of specified statutes that existed in the 1970s. In addition, as with federal agencies, virtually all of LSC's annual revenues come from its annual appropriations from Congress. Further, with the creation of an OIG within LSC, it is subject to an OIG governance structure comparable to those of federal agencies and U.S. government corporations. LSC also submits its budget through the congressional appropriations process and is subject to other congressional oversight. In other respects, LSC is not subject to the standard governance and accountability requirements for federal entities, including provisions related to performance and financial reporting, internal controls, and funds control.

The governance practices of LSC's board fall short of the modern practices employed by boards of nonprofit corporations and public companies. By updating and strengthening its governance and accountability structures, LSC can increase assurance that federal funds are spent properly and effectively in order to meet the needs of grant recipients. The board members have demonstrated active involvement in LSC through their regular board meeting attendance and participation. There are several areas, however, where LSC's governance practices can be strengthened,

⁷Public company is a general term used to refer to a corporation owned by shareholders whose securities are sold to the general public, typically through the stock exchange, and governed by the requirements of the securities laws.

including a more comprehensive orientation program for new board members and an ongoing training program that enables board members to stay current on governance practices, the regulatory environment, and key management practices. Keeping current with governance practices is especially important for the LSC board because the board composition changes significantly with each new presidential administration, and thus the board does not generally have the benefit of experienced board members. Although the LSC board has four committees, including finance and operations and regulations, it does not have audit, ethics, or compensation committee, important governance mechanisms commonly used in corporate governance structures. Finally, the board has not assessed the performance, collectively or individually, of its board members. Until it incorporates many practices currently considered necessary for effective governance, LSC's Board of Directors is at risk of not fulfilling its role of effective governance and oversight in keeping with its fiduciary duties. Recent incidents of compensation rates that exceed a statutory limitation, questionable expenditures, and potential conflicts of interest may have been prevented by a properly implemented governance structure.

LSC's management practices have not kept up with the current practices for key processes in the areas of risk assessment, internal control, and financial reporting. We found that management has not implemented a systematic or formal risk assessment that evaluates the risks the corporation faces from both external and internal sources. Such an assessment provides a structure for implementing internal control and other risk mitigation policies. Without an effective program of risk assessment and internal control, LSC management does not have adequate assurance that it is using organizational resources effectively and efficiently, nor reasonable assurances that LSC's assets and operations are protected. In addition, senior management has not established comprehensive policies or procedures regarding conflicts of interest or other issues of ethical conduct. Without such policies and procedures, LSC is at risk of not identifying potential conflicts of interest and taking appropriate actions to avoid potentially improper transactions or actions on the part of LSC personnel and the resulting loss of credibility to LSC as an organization. Also, management has not conducted its own assessment or analysis of accounting standards to determine the most appropriate standards for LSC to follow. Consequently, it is not clear which standards are most relevant for LSC to follow and which would provide the best financial information to LSC's management and financial statement users.

In this report we have included a matter for congressional consideration concerning whether LSC should have additional legislatively mandated governance and accountability requirements modeled after what has worked successfully at federal agencies or U.S. government corporations. These requirements could be established either by amending LSC's current governing statutes or by converting LSC to a federal entity, such as a U.S. government corporation or an independent federal agency. We are also making recommendations to LSC's board for modernizing and strengthening its governance and oversight, including action directed at formalizing a comprehensive orientation program and an ongoing training program, conducting a performance assessment, creating audit and compensation committees, developing and implementing an approach to evaluate certain key management processes periodically, and ensuring that LSC's audited financial statements are issued more promptly. We are also making recommendations to LSC management directed at improving its accountability by conducting a risk assessment and implementing a corresponding risk management program as part of a comprehensive evaluation of internal control, including establishing policies for handling conflicts of interest (ethics) and evaluating accounting standards.

We received written comment letters from the Chairman on behalf of LSC's Board of Directors and the President on behalf of LSC's management. Both the Chairman and President expressed their commitment to achieving strong governance and accountability and outlined actions that LSC's board and management plan to take in response to our recommendations. Both LSC's Chairman and President commented on the matter that we presented for congressional consideration and provided their views that LSC's governing statutes are appropriate and have worked well and stated that many of the governance recommendations could be accomplished without changing the statutory framework of LSC. We presented the options of amending LSC's governing statutes to improve governance and accountability requirements or converting LSC to a federal entity, which would include compliance with related governance and accountability requirements, since federal agencies and government corporations have been subject to strengthened governance and accountability requirements over recent years and LSC has not kept up with evolving reforms.

Background

LSC is a private, nonprofit corporation that is federally funded for the purpose of making federal resources available to support local providers of civil legal services for low-income people, with the goal of providing equal access to the justice system "for individuals who seek redress of

grievances” and “who would be otherwise unable to afford adequate legal counsel.” Since LSC was federally chartered by statute over three decades ago in the LSC Act, Congress has been making annual appropriations to LSC to provide grants to eligible legal service providers to carry out the purposes of the LSC Act’s requirement “to provide the most economical and effective delivery of legal assistance.”⁸ Since 1996, LSC has been required to select its grant recipients through a competitive award process.⁹ Today, LSC funds grant recipients in all 50 states, as well as the District of Columbia and all five U.S. territories. In fiscal year 2006, LSC reported distributing a total of \$313.9 million in grants.

Local legal service providers employ staff attorneys to assist eligible clients in resolving their civil legal problems, often through advice and referral. According to LSC, in a typical year the largest portion of total cases (38 percent) concern family matters, followed by housing issues (24 percent), income maintenance (13 percent), and consumer finance (12 percent). LSC reported that most cases are resolved out of court. In 2007, LSC reported that three out of four clients were women, most of them mothers. Most clients were at or below 125 percent of the federal poverty threshold, currently an income of approximately \$25,000 a year for a family of four. The type of legal assistance that LSC funding supports is subject to certain legal restrictions. By law, for example, LSC cannot provide funds for legal services for a proceeding related to a violation of the Military Selective Service Act or participation in litigation related to abortion or a criminal proceeding.

In 1974, Congress enacted the LSC Act to transfer the functions of the Legal Services Program from the Executive Office of the President into a private corporation.¹⁰ Through the LSC Act, Congress chartered LSC in the District of Columbia as a private, nonmembership,¹¹ nonprofit corporation

⁸*See, e.g.*, the LSC appropriations act for fiscal year 2006, Pub. L. No. 109-108, 119 Stat. 2290, 2330 (Nov. 22, 2005); *see also* the LSC Act, at 42 U.S.C. § 2996f(a)(3).

⁹The competitive award requirement was first enacted in administrative provisions included in the LSC appropriations act for fiscal year 1996 and has been annually reenacted since then. *See, e.g.*, Department of State and Related Agencies Appropriations Act, 1996, Pub. L. No. 104-134, tit. IV, § 503, 110 Stat. 1321, 1321-52 (Apr. 26, 1996). LSC has issued implementing regulations at 45 C.F.R. pt. 1634.

¹⁰For more information about the origin and creation of LSC, see app. I.

¹¹A nonmembership corporation is a corporation without shares and shareholders, meaning that nobody owns a property interest in the corporation.

that would not be considered a department, agency, or instrumentality of the federal government. Under its federal charter (the LSC Act), LSC may only pursue activities consistent with the corporate purpose of “providing financial support for legal assistance in noncriminal proceedings or matters to persons financially unable to afford legal assistance.”

To direct the corporation, the LSC Act provides for a bipartisan Board of Directors consisting of 11 voting members who are appointed by the President of the United States with the advice and consent of the U.S. Senate. Neither the President nor the Senate has the power to remove a director. A director can only be removed for cause, such as a persistent neglect of duties, by a vote of at least 7 directors. Although the LSC Act does not require board members to possess management or financial expertise, it does include some membership requirements: no director may be a full-time U.S. government employee, a majority of the directors must be attorneys belonging to the bar of the highest court of a U.S. state, and at least one director must be from the legal service client community. The LSC Act requires the board to meet at least four times each calendar year and prohibits board members from participating in any decision, action, or recommendation related to a matter that directly benefits the board member or pertains specifically to any entity with which the board member has been associated in the past 2 years.¹² The LSC Act prohibits LSC personnel and grant recipients from engaging in certain prohibited activities, such as legal assistance related to a criminal proceeding or participation in litigation related to an abortion, and the LSC Board of Directors, which is charged with managing the affairs of the corporation, is responsible for ensuring compliance with these restrictions.

The LSC Act requires the Board of Directors to appoint the LSC President and any other necessary officers,¹³ and provides that the LSC President may appoint any employees necessary to carry out LSC’s purposes. LSC officers and employees can be fairly easily appointed and removed,

¹²The LSC Act provides no similar conflict-of-interest provision for its officers, employees, or other agents, such as outside consultants.

¹³Similarly, the D.C. Nonprofit Corporation Act calls for a nonprofit corporation’s board of directors to appoint a president, secretary, treasurer, and any other necessary officers and assistant officers, as provided in the corporation’s bylaws. D.C. Code § 29-301.24.

creating essentially at-will employment¹⁴ relationships. In addition to the power to appoint and remove LSC employees and to serve as an ex-officio,¹⁵ nonvoting member of the Board of Directors, the LSC President, who is the only officer specifically provided for in the LSC Act, is authorized to make grants and enter into contracts that bind LSC.

As a D.C. nonprofit corporation, LSC generally possesses all the powers conferred on such corporations under the D.C. Nonprofit Corporation Act, which includes a number of general corporate powers,¹⁶ such as the power to sue and be sued in its corporate name, exercise a number of rights related to real and personal property, enter into contracts, and borrow money and issue debt obligations. Other corporate powers include investing and lending money, appointing officers and agents and defining their duties and fixing their compensation, making bylaws to administer and regulate corporate affairs, and “hav[ing] and exercis[ing] all powers necessary or convenient to effect any or all of the purposes for which the corporation is organized.” LSC’s exercise of such corporate powers, however, is restricted where inconsistent with the LSC Act. For example, the LSC board’s discretion in fixing its officers’ and employees’ compensation is limited by an LSC Act provision prohibiting LSC from compensating its personnel at rates in excess of the rate of level V of the Executive Schedule.¹⁷

Unlike most D.C. nonprofit corporations, LSC’s exercise of its corporate powers has received additional oversight since 1988 when Congress subjected LSC to the Inspector General Act of 1978, as amended (IG Act).¹⁸

¹⁴At-will employment is a common term used in labor law to refer to the relationship established when an employer hires an employee for an indefinite term without a written employment contract that allows the employer to terminate the employee for any reason, with or without cause, so long as it is not an illegal reason, such as racial discrimination prohibited under a state’s wrongful termination laws or retaliation for whistleblowing under state or federal whistleblower laws, state employer retaliation laws, or both.

¹⁵An ex-officio board member is a member not by appointment but by virtue of holding a certain corporate office, such as being the president of the corporation.

¹⁶D.C. Code § 29-301.05.

¹⁷The LSC Act, 42 U.S.C. § 2996d(d), incorporates by reference 5 U.S.C. § 5316, which provides the pay cap provided for federal employees paid at level V of the Executive Schedule. Each calendar year, the Office of Personnel Management publishes the new amount of the pay cap for level V, such as \$133,900 for calendar year 2006.

¹⁸5 U.S.C. appx.

As an independent office within LSC, the LSC OIG is authorized to carry out audits and investigations of LSC programs and operations, recommend policies to improve program administration and operations, and keep the LSC board and Congress fully and currently informed about problems in program administration and operations and the need for and progress of corrective action.¹⁹ Also, unlike most D.C. nonprofit corporations, LSC is subject to congressional oversight through the annual appropriations process as well as responding to congressional inquiries and participating in hearings. In its annual appropriation for LSC, Congress regularly appropriates a specific amount for the OIG. For example, Congress appropriated about \$2.54 million for the LSC OIG in fiscal years 2006 and 2007.²⁰ Because in fiscal year 2007 LSC received an increase in its annual appropriation of about \$17.78 million that was not allocated for a specific purpose, LSC officials told us that LSC, consistent with congressional guidance,²¹ used \$430,000 of this amount to increase funding for the OIG from about \$2.54 million in fiscal year 2006 to \$2.97 million in fiscal year 2007. (See fig. 1.)

It has been three decades since LSC was last comprehensively reviewed and reauthorized in the Legal Services Corporation Amendments Act of 1977,²² and LSC's statutory framework has undergone only limited changes since then. Today LSC is governed by the powers and restrictions in its federal charter (the LSC Act) and, where not inconsistent, the D.C. Nonprofit Corporation Act,²³ as well as the IG Act, the federal tax law requirements for tax-exempt status for nonprofit corporations, and LSC's annual appropriations acts, which since 1996 have included a number of administrative provisions imposing additional grants management duties.

¹⁹5 U.S.C. appx. § 4(a).

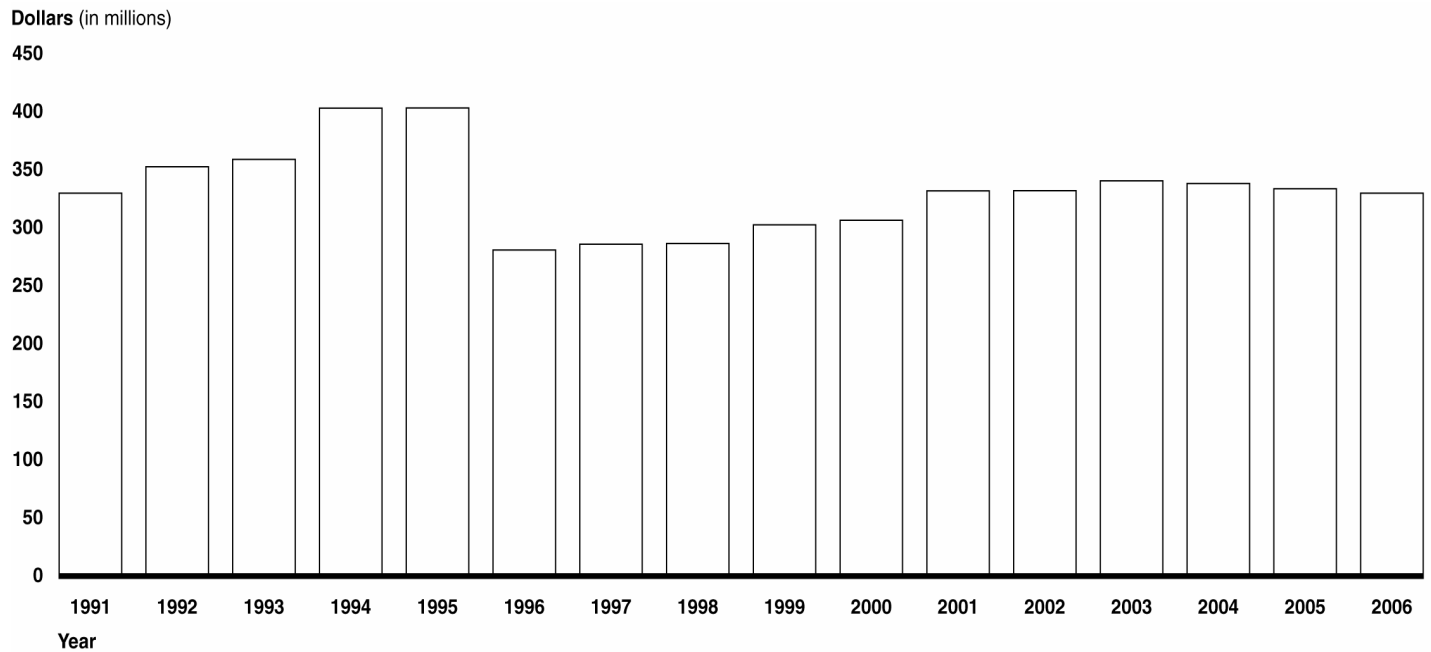
²⁰Revised Continuing Appropriations Resolution, Pub. L. No. 110-5, § 104, 121 Stat. 8, 9 (Feb. 15, 2007); *see also* the LSC appropriations act for fiscal year 2006, Pub. L. No. 109-108, 119 Stat. 2290, 2330 (Nov. 22, 2005).

²¹In their reports associated with the fiscal year 2007 appropriations for LSC, the House and Senate Committees on Appropriations both directed LSC to allocate \$2.97 million for the LSC OIG. *See* H.R. Rep. No. 109-520, at 136 (June 22, 2006); S. Rep. No. 109-280, at 137 (July 13, 2006).

²²Legal Services Corporation Act Amendments of 1977, Pub. L. No. 95-222, 91 Stat. 1619 (Dec. 28, 1977).

²³D.C. Code, tit. 29, ch. 3.

Figure 1: Legal Services Corporation Federal Funding between Fiscal Years 1991 and 2006



Source: GAO based on LSC audited financial statements.

Unlike most private, nonprofit corporations, the vast majority of LSC’s funding comes from annual federal appropriations, which originally were authorized under the LSC Act. The LSC Act specifies that the appropriated funds authorized under the act are available until expended and shall be paid to LSC in one annual installment at the start of the fiscal year. Although annual appropriations for LSC have not been authorized since fiscal year 1980 under the LSC Act, Congress has continually enacted annual appropriations to be paid to LSC to carry out the purposes of the LSC Act. For fiscal year 2007, Congress appropriated almost \$349 million for LSC. The LSC Act permits LSC to receive and retain nonfederal funds, but LSC’s recent audited financial statements show that for fiscal years 1991 through 2006, approximately 99 percent of LSC’s revenues came from federal appropriations.²⁴ In addition to direct funding through annual appropriations, the LSC Act makes certain indirect federal support

²⁴See, e.g., Legal Services Corporation, *Financial Statements and Independent Auditors’ Report, September 30, 2006 and 2005* (Washington, D.C.: June 6, 2007), which shows that about 99 percent of LSC’s revenues in fiscal year 2006 came from federal appropriations.

available to LSC by providing that the President of the United States may make support functions of the federal government available to LSC.²⁵

For both governmental and nonprofit entities, governance can be described as the process of providing leadership, direction, and accountability in fulfilling the organization's mission, meeting objectives, and providing stewardship of public resources, while establishing clear lines of responsibility for results. Accountability represents the processes, mechanisms, and other means—including financial reporting and internal controls—by which an entity's management carries out its stewardship and responsibility for resources and performance. To provide accountability to Congress, the LSC Act provides for Senate advice and consent on the selection of board members, annual appropriations that constitute virtually all of LSC's annual revenues, and treatment of LSC as a federal entity in limited situations either by directly subjecting LSC to certain federal laws or indirectly by modeling provisions in the LSC Act after provisions in laws existing in the 1970s. For example, the LSC Act makes LSC subject to provisions in the Freedom of Information Act (FOIA) and the Government in the Sunshine Act, compensation limits imposed on officers and employees at level V of the Executive Schedule, and employer contribution requirements for participation in certain employee benefits programs, as well as requiring LSC to engage in notice-and-comment rule making and to provide us with access to its records.

²⁵The LSC Act also provides indirect federal support by providing that LSC personnel are eligible to participate in federal employee benefits programs related to the Civil Service Retirement System (CSRS), group life insurance, health insurance, and work-related injuries. A later-enacted statute, however, eliminated eligibility for participation in the first three programs for all LSC personnel except those hired before October 1, 1988. *See* Pub. L. No. 100-238, § 108, 101 Stat. 1744, 1747-48 (Jan. 8, 1988), *codified*, at 5 U.S.C. §§ 8347(o) [retirement], 8713 [life insurance], 8914 [health insurance]. LSC personnel eligible to participate in CSRS are also eligible to make contributions to the Thrift Savings Plan, a federal employee defined-contribution retirement plan. *See* 5 U.S.C. § 8351. According to an LSC official, however, today all LSC personnel remain eligible for benefits for work-related injuries under the Federal Employees' Compensation Act, *codified, as amended*, at 5 U.S.C. ch. 81.

LSC Is Subject to Weaker Governance and Accountability Requirements Than Federal Entities but More Federal Oversight Than Nonprofit Corporations

Although LSC is subject to more statutory governance and accountability requirements than most private, nonprofit corporations, it is subject to governance and accountability requirements that are weaker than those of most independent federal agencies²⁶ headed by boards or commissions and U.S. government corporations. In chartering a private, nonprofit corporation to perform a public assistance role with federal funding, Congress in the 1970s included certain provisions in the LSC Act to provide for governance and accountability. The LSC Act includes provisions providing that LSC shall be treated like a federal agency for purposes of specified statutes that existed in the 1970s when the LSC Act was first enacted and amended. In 1988, Congress created an OIG within LSC. Therefore, LSC is subject to some governance and accountability requirements that are comparable to those of federal entities, including the presence of an OIG in the governance structure and submission of its budget for the congressional appropriations process. Nonprofit corporations typically are subject to limited federal requirements related to governance and accountability; however, as discussed later, nonprofit corporations have voluntarily chosen to incorporate many practices in these areas. In other respects, LSC is not subject to standard governance and accountability requirements for federal entities including provisions related to performance and financial reporting, internal controls, and funds control. Additional management areas are discussed in appendix III, and an expanded table is in appendix IV.

Governance Structures

Similar to most independent federal agencies and U.S. government corporations, LSC is headed by a multiperson body (i.e., commission or board of directors) consisting of presidentially appointed and Senate-confirmed members²⁷ and has an OIG. (See table 1.)

²⁶Independent agencies are federal agencies separate from larger agencies or departments and are labeled “independent” by law or are controlled by a multiperson body. Thus, the Social Security Administration (SSA) is an independent agency, but the Food and Drug Administration, which is part of the Department of Health and Human Services, is not an independent agency. Unlike the Securities and Exchange Commission or the National Science Foundation, however, SSA is not headed by a multiperson body, such as a commission or a board.

²⁷Independent federal agencies headed by a multiperson body have commissioners or directors, while LSC and U.S. government corporations have only directors.

Table 1: Key Statutory Governance Structures

	LSC	Independent federal agencies	U.S. government corporations	D.C. nonprofit corporations
Inspector general	IG Act	IG Act	IG Act	Generally not applicable, but IG Act applies to the Corporation for Public Broadcasting (CPB)
Committees authorized	D.C. Code § 29-301.22	Committees neither prohibited nor required	Committees neither prohibited nor required	D.C. Code § 29-301.22
Governing body	Board of directors: presidential appointment with Senate approval and for cause removal by vote of seven directors	Independent federal agencies headed by a multiperson body: Commission or board of directors: Mostly presidential appointment with Senate approval, often silent on removal	Board of directors: Mostly presidential appointment with Senate approval, often silent on removal	Board of directors: D.C. Code §§ 29-301.18, 29-301.19; CPB Act, presidential appointment with Senate approval, silent on removal

Source: GAO.

A common form of governance for independent federal agencies and U.S. government corporations is a multiperson body consisting of either a board of directors (agencies and corporations) or a commission (only agencies), both of whose members are generally appointed by the President of the United States and confirmed by the U.S. Senate. For example, the President appoints and the Senate confirms the members of the boards of directors for the Federal Deposit Insurance Corporation (FDIC) and Pension Benefit Guaranty Corporation (PBGC) (both U.S. government corporations),²⁸ the National Science Foundation (NSF) and the Federal Housing Finance Board (both independent federal agencies),²⁹ as well as the commissioners of the Securities and Exchange Commission (SEC) and the Nuclear Regulatory Commission (NRC) (both independent federal agencies).³⁰

The directors of LSC may only be removed for cause by a vote of seven other directors. This level of statutory removal protection is unique in two ways. First, it restricts the reasons for removal to only those listed in the

²⁸See 12 U.S.C. § 1812(a); 29 U.S.C. § 1302(d).

²⁹See 42 U.S.C. § 1863(a); 12 U.S.C. 1422a(b).

³⁰See 15 U.S.C. § 78d(a); 42 U.S.C. § 5841(b).

statute, and second, it precludes removal by the President of the United States or Congress. In many cases, the board or commission members of a federal entity have less tenure protection and serve at the will of the President of the United States, such as the PBGC directors, who are the Secretaries of Labor, the Treasury, and Commerce. Nonprofit corporations incorporated in the District of Columbia are required to be managed by a board of directors, consisting of at least three directors, who serve for the terms specified in the articles of incorporation or bylaws. A director of a D.C. nonprofit corporation may be removed by any procedure provided in the articles of incorporation or bylaws. If not so provided, then removal with or without cause is permitted upon a vote that would suffice for the election of a director for the organization.³¹

No federal law specifically requires the board of directors of a U.S. government corporation or a board of directors or commission of an independent federal agency to designate audit or other committees, but neither does any law prohibit the establishment of such committees. The D.C. Nonprofit Corporation Act expressly authorizes, but does not require, boards of nonprofit corporations to designate and delegate authority to committees.³² In certain instances, the statutes establishing federal entities may authorize the designation and delegation of authority to committees, such as the statute governing NSF (an independent federal agency).³³

Since 1977, there has been only one governmentwide management law that specifically included LSC as a covered entity and thus required a change to LSC's governance structure. In 1988, Congress amended the IG Act³⁴ to add OIGs to additional entities receiving significant federal funding, including "designated federal entities" (DFE), which are statutorily defined.³⁵ LSC was listed as a DFE, along with such other entities as PBGC, SEC, and Amtrak, which are, respectively, a wholly owned U.S. government corporation, an independent federal agency, and a

³¹D.C. Code §§ 29-301.18, -301.19.

³²D.C. Code § 29-301.22.

³³42 U.S.C. § 1863(i).

³⁴The Inspector General Act Amendments of 1988, Pub. L. No. 100-504, 102 Stat. 2515 (Oct. 18, 1988), which amended the Inspector General Act of 1978, Pub. L. No. 95-452, 92 Stat. 1101 (Oct. 12, 1978), which together are *codified, as amended, at 5 U.S.C. appx.*

³⁵5 U.S.C. appx. § 8G(a)(2).

federally established private, for-profit corporation that receives some federal funding.³⁶ The only other private, nonprofit corporation included as a DFE was CPB. Like the other OIGs of DFEs that are independent federal agencies and U.S. government corporations, the LSC OIG was created as an “independent and objective” office to carry out audits and investigations of LSC programs and operations, recommend policies to improve program administration and operations, and keep the LSC board and Congress fully and currently informed about problems in program administration and operations and the need for and progress of corrective action.³⁷ In its annual appropriation for LSC, Congress regularly appropriates a specific amount for the OIG. For example, Congress appropriated about \$2.54 million for the LSC OIG in fiscal years 2006 and 2007.³⁸ Because in fiscal year 2007 LSC received an increase in its annual appropriation of about \$17.78 million that was not allocated for a specific purpose, LSC officials told us that LSC, consistent with congressional guidance,³⁹ used \$430,000 of this amount to increase funding for the OIG from about \$2.54 million in fiscal year 2006 to \$2.97 million in fiscal year 2007.

Funds Control and Budgeting

Like other private, D.C. nonprofit corporations, LSC is not subject to federal funds control laws that generally apply to independent federal agencies and many U.S. government corporations, including the Antideficiency Act, the Purpose Statute, and laws governing liability of accountable officers for improper or illegal uses of funds; however, LSC is required to submit an annual budget request to Congress. (See table 2.)

³⁶ 49 U.S.C. § 24301. Also known as the National Railroad Passenger Corporation, Amtrak was established by the Railroad Passenger Act of 1970, Pub. L. No. 91-518, § 301, 84 Stat. 1327, 1330 (Oct. 30, 1970). Amtrak depends on annual appropriations for some of its funding. *See, e.g.*, Department of Transportation Appropriations Act, 2006, Pub. L. No. 109-115, 119 Stat. 2396, 2413-14, which appropriates \$495 million to the Secretary of Transportation to make quarterly operating subsidy grants to Amtrak (Nov. 30, 2005).

³⁷ 5 U.S.C. appx. §§ 2, 6, 8G, 11.

³⁸ Revised Continuing Appropriations Resolution, Pub. L. No. 110-5, § 104, 121 Stat. 8, 9 (Feb. 15, 2007); *see also* the LSC appropriations act for fiscal year 2006, Pub. L. No. 109-108, 119 Stat. 2290, 2330 (Nov. 22, 2005).

³⁹ In their reports associated with the fiscal year 2007 appropriations for LSC, the House and Senate Committees on Appropriations both directed LSC to allocate \$2.97 million for the LSC OIG. *See* H.R. Rep. No. 109-520, at 136 (June 22, 2006); S. Rep. No. 109-280, at 137 (July 13, 2006).

Table 2: Key Statutory Funds Control and Budgeting Requirements

	LSC	Independent federal agencies	U.S. government corporations	D.C. nonprofit corporations
Limitation on amount of funds available for use	None	Antideficiency Act	Wholly owned U.S. government corporations: Antideficiency Act	None
Use of funds for authorized purposes only	None	Purpose Statute (31 U.S.C. § 1301(a))	Purpose Statute (31 U.S.C. § 1301(a))	None
Annual budget	LSC Act (request made directly to Congress): no content or form requirements; Office of Management and Budget comment and review allowed)	31 U.S.C. §§ 1105, 1108 (agency budget submitted to the President for inclusion in the Budget of the U.S. Government)	Wholly owned U.S. government corporations: 31 U.S.C. § 1105 and 31 U.S.C. § 9103 (Government Corporation Control Act)	Generally not applicable; CPB prepares an annual budget
Liability of accountable officers for improper or illegal use of funds	None	31 U.S.C. §§ 3528, 3325	Some wholly owned U.S. government corporations: 31 U.S.C. §§ 3528, 3325	None

Source: GAO.

Like many independent federal agencies and wholly owned government corporations, most of LSC’s annual revenues come from federal funds made available through annual appropriations; however, LSC is not required by law to control its use of those funds as are independent federal agencies and wholly owned U.S. government corporations.⁴⁰ The Antideficiency Act, among other things, prohibits officers and employees of the government from obligating or expending funds in advance of or in excess of appropriations.⁴¹ This applies to the officers and employees of independent federal agencies and wholly owned U.S. government corporations, where personnel are officers and employees of the government. The Purpose Statute requires federal agencies and all U.S. government corporations, both mixed ownership and wholly owned, to use appropriated funds only for the purposes provided in law.⁴² Further, for most federal agencies and some wholly owned U.S. government corporations, such as the Tennessee Valley Authority and the Federal

⁴⁰For a discussion of the application of funds control laws to U.S. government corporations, see GAO, *Principles of Federal Appropriations Law*, vol. IV, 2d ed., [GAO-01-179SP](#) (Washington, D.C.: March 2001), 17-130 to 17-152.

⁴¹31 U.S.C. § 1341.

⁴²31 U.S.C. § 1301(a).

Prisons Industries Incorporated,⁴³ accountable officers⁴⁴ are financially liable for improper or illegal payments.⁴⁵ None of these funds control statutes apply to LSC or, in general, other nonprofit corporations that receive federal funds.⁴⁶ The LSC Act does contain a number of provisions that restrict the use of LSC's appropriated funds for certain purposes, such as an activity that would influence the passage or defeat of any legislation at the local, state, or federal level or that would support any political party or campaign of any candidate for public office.⁴⁷

Unlike D.C. nonprofit corporations in general, and like independent federal agencies and wholly owned U.S. government corporations, each year LSC must prepare a new budget request as part of the annual appropriations process. The LSC Act requires LSC to submit a budget request to Congress, but provides no requirements related to the form and content of the budget request. For federal agencies and wholly owned U.S. government corporations, the Office of Management and Budget (OMB) prescribes the form and content of budget requests, consistent with specified statutory requirements, that are submitted through the President to Congress.⁴⁸ Under the LSC Act, LSC submits that budget request directly to Congress, with OMB's role limited to submitting comments to Congress if it chooses to review LSC's budget. As a federally chartered, private nonprofit D.C. corporation, CPB also must annually prepare a budget request as part of the annual appropriations process. Unlike LSC, however, CPB requests and receives funding for 2 years (i.e., funding for fiscal 2008

⁴³16 U.S.C. § 831h(c); 18 U.S.C § 1426(d).

⁴⁴Accountable officers are government officials and employees who are subject to personal pecuniary liability for the receipt, possession, or use of federal funds. Examples of accountable officers include (1) disbursing officers, who draw federal funds from the U.S. Treasury to make payments, usually based on certified payment vouchers, and account for those funds, and (2) certifying officers, who review and certify payment vouchers for legality, propriety, and accuracy for a disbursing officer. See GAO, *Principles of Federal Appropriations Law*, vol. II, 3d ed, [GAO-06-382SP](#) (Washington, D.C.: February 2006), 9-11 to 9-20, for a discussion of who is an accountable officer.

⁴⁵31 U.S.C. §§ 3325, 3528.

⁴⁶See B-308037, Sept. 14, 2006; B-241591, Mar. 1, 1991; B-204886, Oct. 21, 1981.

⁴⁷LSC Act, at 42 U.S.C. §§ 2996e(c)(2), 2996e(d)(3).

⁴⁸See 31 U.S.C. §§ 1105, 1108, 9103.

was provided in the fiscal year 2006 appropriations act.)⁴⁹ Once the level of the annual appropriations act is enacted, CPB's appropriation is paid into the Public Broadcasting Fund, which is a fund established in the Treasury and administered by the Secretary of the Treasury. In accordance with CPB's federal charter, CPB determines how to allocate amounts in the fund.⁵⁰

Performance and Financial Reporting

Unlike D.C. nonprofit corporations in general but like CPB, the LSC Act requires LSC to have its accounts audited annually. By contrast, independent federal agencies and U.S. government corporations are subject to more detailed financial and performance planning and reporting requirements. When the LSC Act was enacted in the 1970s, audited financial statements were not prepared for federal agencies and LSC as a private, nonprofit corporation was not subject to the financial audit requirements imposed on public companies and U.S. government corporations. The LSC Act requires LSC to have its accounts audited by an independent public accountant annually in accordance with generally accepted auditing standards (GAAS). The LSC Act does not detail what must be included in the report or which accounting standards to use. The LSC Act requires LSC to file this annual audit report with us and make the audit report available for public inspection at LSC headquarters during normal business hours. (See table 3.)

⁴⁹See, e.g., Departments of Labor, Health and Human Services, and Education, and Related Agencies Appropriations Act, 2006, Pub. L. No. 109-149, 1990 Stat. 2833, 2874 (Dec. 30, 2005). ("For payment to the Corporation for Public Broadcasting, as authorized by the Communications Act of 1934, an amount which shall be available within limitations specified by that Act, for the fiscal year 2008, \$400,000,000....")

⁵⁰47 U.S.C. § 396(k).

Table 3: Key Statutory Provisions for Performance and Financial Reporting

	LSC	Independent federal agencies	U.S. government corporations	D.C. nonprofit corporations
Financial statements or report	Annual report on corporation accounts: LSC Act (report of annual audit of LSC's accounts)	Annual audited financial statements: 31 U.S.C. § 3515 (Chief Financial Officers Act of 1990, Government Management Reform Act of 1994, Accountability of Tax Dollars Act of 2002)	Annual audited financial statements: 31 U.S.C. §§ 9105, 9106 (Government Corporation Control Act)	D.C. Code § 29-301.26 (keep correct and complete books and records of account); CPB required to prepare annual audit report on CPB accounts
Accounting standards applied in practice	No generally accepted accounting principles (GAAP) specified; LSC now using Government Accounting Standards Board GAAP	Federal Accounting Standards Advisory Board (FASAB) GAAP	Some FASAB GAAP; some Financial Accounting Standards Board (FASB) GAAP	FASB GAAP
Performance and strategic plans and reports	None	Strategic plans: 5 U.S.C. § 306; performance plans and reports: 31 U.S.C. §§ 1115-1116 (Government Performance and Results Act of 1993)	Strategic plans: 5 U.S.C. § 306; performance plans and reports: 31 U.S.C. §§ 1115-1116 (Government Performance and Results Act of 1993)	D.C. Code § 29-301.26 (keep minutes of board proceedings); CPB required to submit annual report to President and Congress

Source: GAO.

The LSC Act requirements for financial reporting are more rigorous than the requirements for D.C. nonprofit corporations in general but less than those for CPB. Most D.C. nonprofit corporations are only required to keep correct and complete books and records of account and minutes of the proceedings of their boards of directors. This information is not required to be published or made available for public inspection.⁵¹ Similar to LSC, CPB is required to annually have its accounts audited by an independent public accountant in accordance with GAAS.⁵² CPB's audit report must be included in its annual report on its operations and activities, which it must submit to the President for transmittal to Congress.⁵³ Like most D.C.

⁵¹D.C. Code § 29-301.26.

⁵²47 U.S.C. § 396(i)(1)(B).

⁵³47 U.S.C. § 396(i), (1)(1)(B).

nonprofit corporations, LSC is not required to submit a similar annual report on its operations and activities to the President or Congress.⁵⁴

Independent federal agencies and U.S. government corporations have stronger financial and performance reporting requirements than LSC. The Chief Financial Officers Act of 1990 (CFO Act), as amended by the Government Management Reform Act of 1994 (GMRA), requires the major 24 agencies⁵⁵ of the federal government, including some independent federal agencies such as NSF and NRC, to submit annual audited financial statements to OMB and Congress.⁵⁶ These financial statements must be prepared in accordance with generally accepted accounting principles and audited in accordance with applicable generally accepted government auditing standards (GAGAS). The Accountability of Tax Dollars Act of 2002 (ATDA) expanded this requirement⁵⁷ to include most other federal executive agencies.⁵⁸ U.S. government corporations had been subject to financial reporting requirements for many years under the Government

⁵⁴Under the LSC Act, LSC had been required to publish an annual report to be filed with the President and Congress. *See* 42 U.S.C. § 2996g(c). However, this reporting requirement was terminated on May 12, 2000, under the Federal Reports Elimination and Sunset Act of 1995, Pub. L. No. 104-66, § 3003, 109 Stat. 707, 734-36 (Dec. 21, 1995) (reprinted, as amended, in 31 U.S.C. § 1113 note).

⁵⁵The current 24 CFO Act agencies are the Departments of Agriculture, Commerce, Defense, Education, Energy, Health and Human Services, Homeland Security, Housing and Urban Development, the Interior, Justice, Labor, State, Transportation, the Treasury, and Veterans Affairs as well as the Environmental Protection Agency, National Aeronautics and Space Administration, Agency for International Development, General Services Administration, National Science Foundation, Nuclear Regulatory Commission, Office of Personnel Management, Small Business Administration, and Social Security Administration. 31 U.S.C. § 901(b).

⁵⁶*See* 31 U.S.C. § 3515 (a). The Reports Consolidation Act of 2000, Pub. L. No. 106-531, § 4(a), 114 Stat. 2537, 2539 (Nov. 22, 2000), added a requirement that the audited financial statements shall also be submitted to Congress.

⁵⁷The requirement for submitting annual audited financial statements to OMB and Congress under the CFO Act, GMRA, and ATDA has been codified, as amended, at 31 U.S.C. § 3515.

⁵⁸31 U.S.C. § 3515(f). OMB specifically identified 76 agencies to which ATDA expanded the annual financial reporting requirement in Appendix A of M-04-22, a July 2004 memorandum titled “Amendments to OMB Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.” This bulletin and related memorandum have been superseded by OMB Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements* (Aug. 23, 2006), which in Appendix C identifies 75 entities to which the ATDA expanded the annual financial reporting requirement.

Corporation Control Act.⁵⁹ Chapter 91 of Title 31 of the U.S. Code, commonly known as the Government Corporation Control Act, requires both mixed-ownership and wholly owned U.S. government corporations to submit annual management reports to Congress (with copies to the President, OMB, and GAO) no later than 180 days after the end of the government corporation's fiscal year. OMB has accelerated the submission deadline to no later than 45 days after the end of the government corporation's fiscal year.⁶⁰ Annual management reports are required to include a

- statement of financial position;
- statement of operations;
- statement of cash flows;
- reconciliation to the budget report of the corporation, if applicable;
- statement of internal accounting and administrative control systems by the head of corporation management, consistent with the requirements under amendments to the act made by 31 U.S.C. § 3512 (c), (d), commonly referred to as the Federal Managers' Financial Integrity Act of 1982 (FMFIA);
- a financial statement audit report prepared in accordance with GAGAS; and
- any other information necessary to inform Congress about the operations and financial condition of the corporation.⁶¹

Under OMB Circular No. A-136, *Financial Reporting Requirements* (rev. July 24, 2006), annual performance and accountability reports (PAR) issued by federal executive agencies consist of the annual performance report required by the Government Performance and Results Act of 1993⁶² with audited financial statements and other disclosures, such as agencies' (1) assurances on internal control, (2) accountability reports by agency heads, and (3) inspectors general's assessments of the agencies' most

⁵⁹Requirements for annual management reports for government corporations have been codified, as amended, at 31 U.S.C. §§ 9105, 9106.

⁶⁰OMB Circular No. A-136, *Financial Reporting Requirements*, pt. I.5 (rev. July 24, 2006).

⁶¹31 U.S.C. § 9106(a)(2).

⁶²The annual program performance report, required by 31 U.S.C. § 1116, shall reflect, among other things, the agency's or corporation's progress in achieving the performance goals set out in its annual performance plan, required by 31 U.S.C. § 1115, which implements a mandatory longer-term strategic plan, required by 5 U.S.C. § 306.

serious management and performance challenges.⁶³ OMB Circular No. A-136 states that PARs are intended to provide financial and performance information to enable the President, Congress, and the public to assess the performance of a federal agency relative to its mission and to demonstrate the federal agency's accountability.

LSC follows a fiscal year starting on October 1, and for the past 5 years has issued its financial statements in March or later, which is 6 months after its year-end. As noted, federal agencies are required to issue their financial statements 45 days following their year-ends, which is mid-November.

Internal Control Systems Requirements

LSC's statutory requirements for internal control systems are less rigorous than those for independent federal agencies or U.S. government corporations; D.C. nonprofit corporations have no such statutory requirements. (See table 4.) The LSC Act requires LSC to account for federal funds separately from nonfederal funds, but otherwise includes no specific requirements for the establishment of accounting and internal control systems. The LSC Act imposes some program management duties on the LSC directors to promote good stewardship of federal taxpayer dollars by requiring that the directors manage LSC's programs economically, effectively, and efficiently. For example, the LSC Act requires the LSC board to ensure that LSC makes grants "so as to provide the most economical and effective delivery of legal assistance to persons in both urban and rural areas." The LSC Act also requires the board to ensure that grant recipients adopt procedures for determining priorities on how to allocate their assistance among eligible clients. Additionally, the LSC Act imposes a program evaluation requirement on the board, requiring it to monitor, evaluate, and provide for independent evaluations of LSC-supported programs to ensure that the programs comply with the LSC Act; bylaws; and implementing rules, regulations, and guidelines.

⁶³The Reports Consolidation Act of 2000 (Pub. L. No. 106-531, 114 Stat. 2537 (Nov. 22, 2000) (*codified* at 31 U.S.C. § 3516) permits agencies to submit combined reports in implementing statutory requirements for financial and performance management reporting to improve the efficiency of executive branch performance. These reports are combined in the PAR. In its guidance on financial reporting in OMB Circular No. A-136, OMB converted the PAR option into a mandatory requirement.

Table 4: Key Statutory Internal Control Systems Requirements

	LSC	Independent federal agencies	U.S. government corporations	D.C. nonprofit corporations
System of internal control and assurances	None	31 U.S.C. § 3512(c), (d) (Federal Managers' Financial Integrity Act of 1982)	31 U.S.C. § 9106 (Government Corporation Control Act)	None
Information system security	None	Federal Information Security Management Act of 2002	Federal Information Security Management Act of 2002	None

Source: GAO.

Although the LSC Act includes program management requirements, these are much less rigorous than requirements for systems of internal control, to which federal entities are subject. Managers of federal entities depend on sufficient internal control to achieve desired results through effective stewardship of organizational resources. Internal control, which supports performance-based management, involves the methods and procedures management uses to have reasonable assurance that objectives, such as the following, are being met: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. Federal agencies are subject to the following legislative and regulatory requirements that promote and support effective internal control.

- FMFIA, or 31 U.S.C. § 3512(c), (d), provides the statutory basis for management's responsibility for and assessment of internal control. OMB Circular No. A-123, *Management's Responsibility for Internal Control* (rev. Dec. 21, 2004), sets out the guidance for implementing the statute's provisions, including agencies' assessment of internal control under the standards prescribed by the Comptroller General. Agencies are required to annually provide a statement of assurance on the effectiveness of internal control. U.S. government corporations are not subject to FMFIA, but they are subject to similar requirements under the Government Corporation Control Act, which incorporates by reference the FMFIA standards in requiring U.S. government corporations to include in their annual management reports a statement on internal accounting and administrative control systems.
- The CFO Act requires the 24 CFO Act agencies' chief financial officers (CFO), including the CFOs of such independent federal agencies as NSF and NRC, to maintain an integrated accounting and financial

management system that includes financial reporting and internal controls.⁶⁴

- The Federal Financial Management Improvement Act of 1996,⁶⁵ as implemented by OMB Circular No. A-127, *Financial Management Systems* (rev. Dec. 1, 2004), requires the 24 CFO Act agencies to implement and maintain integrated financial management systems that comply substantially with federal financial management system requirements, applicable federal accounting standards, and the *U.S. Government Standard General Ledger* at the transaction level.

Recent federal governmentwide initiatives have contributed to improvements in financial management and placed greater emphasis on implementing and maintaining effective internal control over financial reporting. In December 2004, OMB issued a significant update to its Circular No. A-123, which is the implementing guidance for FMFIA. The update requires the 24 CFO Act agencies to include the FMFIA annual report in their PARs, under the heading “Management Assurances.” The FMFIA annual report must include a separate assurance on internal control over financial reporting, along with a report on identified material weaknesses and actions taken by management to correct those weaknesses.

FMFIA and OMB Circular No. A-123 apply to each of the three objectives of internal control outlined in GAO’s *Standards for Internal Control in the Federal Government*⁶⁶: effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations. OMB Circular No. A-123 calls for internal control standards to be applied consistently toward each of the objectives. The circular’s new Appendix A, which is a requirement only for the 24 CFO Act agencies, requires management to document the process and methodology for applying A-123 standards when assessing internal control over financial reporting.

One important area of internal control today for both independent federal agencies and U.S. government corporations is the development and

⁶⁴31 U.S.C. § 902(a).

⁶⁵Federal Financial Management Improvement Act of 1996, Pub. L. No. 104-208, div. A., § 101(f), tit. VIII, 110 Stat. 3009, 3009-389 (Sept. 30, 1996) (*reprinted in* 31 U.S.C. § 3512 note).

⁶⁶GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999).

implementation of an entitywide information security program, as required by the Federal Information Security Management Act of 2002 (FISMA).⁶⁷ As part of that program, FISMA requires entity heads to periodically (1) perform risk assessments of the harm that could result from information security problems, such as the unauthorized disclosure or destruction of information; (2) test and evaluate the effectiveness of elements of the information security program; and (3) provide security awareness training to personnel and contractors. FISMA also requires the federal entity to annually have its OIG or an external auditor perform an independent evaluation of the entity's information security programs and practices to determine their effectiveness and to annually submit a report on the adequacy and effectiveness of information systems to OMB, GAO, and Congress.⁶⁸ Because it is not a federal entity, LSC, like CPB and other D.C. nonprofit corporations, is not subject to FISMA and has no special information security requirements.⁶⁹

LSC's Board Members Are Actively Engaged, but the Board's Governance Practices Fall Short of Current Practices of Nonprofit Corporations

LSC board members are actively engaged in the board meeting process as they consistently attend and prepare for board and committee meetings. Board meetings are generally attended by all board members. Board members are provided with an agenda and related materials prior to each board meeting. In addition, board members have interaction with both management and the Inspector General (IG).

Nevertheless, the current board governance practices of LSC's board fall short of current accepted practices employed by boards of nonprofit corporations and public companies. Although LSC has an informal orientation program for its members, the board does not have a comprehensive, formal orientation or an ongoing training program for board members. Keeping up with current practice is especially important for the LSC board because board composition changes significantly with each new presidential administration, resulting in a board that generally does not have the benefit of experienced members. Also, although the

⁶⁷Pub. L. No. 107-347, tit. III, § 301(b)(1), 116 Stat. 2946, 2949 (Dec. 17, 2002), *codified at* 44 U.S.C. § 3544.

⁶⁸44 U.S.C. §§ 3545 (a), (b), 3544(c).

⁶⁹Certain federal contractors, including nonprofit corporations, can be required by statute to implement information security programs consistent with FISMA standards in 44 U.S.C. § 3544. See, e.g., 42 U.S.C. § 1395kk-1(e), which imposes such requirements on Medicare administrative contractors.

board has four established committees, it has not updated its committee structure to include an audit committee or other committees commonly found in nonprofit corporations or public companies today. In addition, the board's current committees do not have charters that identify their purposes and duties, which boards of similar organizations would typically have. Finally, the board does not assess its own performance. Because it has not incorporated many practices currently considered necessary for effective governance, LSC's Board of Directors is at risk of not fulfilling its role in effective governance in keeping with its fiduciary duties. In fact, recent incidents of compensation rates that exceed statutory limitations, questionable expenditures, and potential conflicts of interest may have been prevented by a properly implemented governance structure.

LSC's Board Members Have Actively Engaged through Meeting Attendance and Participation

The current LSC board's 10 members⁷⁰ have attended most or all of the board meetings in recent years. A few board members indicated that their LSC board member role has been more time consuming than they had expected or had experienced as board members with other organizations. According to our survey, most board members are satisfied or very satisfied with the frequency of the board meetings as well as the timeliness and completeness of the information provided (in the board books) to the board members to prepare for meetings. Board members are provided with an agenda and a package of related materials to assist them in preparing for each board meeting. During interviews with us, board members indicated that they also receive information regularly through e-mails and mailings in addition to the board books—primarily from the LSC President. Board members were generally satisfied with their interaction with management, according to our survey, while board members interviewed indicated a range of interaction with the IG—some members only receive information such as the IG reports while others directly discuss issues with the IG. The LSC board has established a conflicts-of-interest policy that requires board members to annually file financial, ownership, and relationship disclosure reports.

LSC's current board of directors carries out its activities primarily during the quarterly meetings of the full board and individual committees. Although the board has established committees with specific members, the committee meetings are typically not held concurrently and most, if

⁷⁰The act provides for a board with 11 voting members, but currently LSC has a vacancy on the board, leaving a current board of 10 members.

not all, board members attend all of the committee meetings, which one board member felt was redundant. The annual board meeting is typically held in January in Washington, D.C., while the remaining three board meetings take place during site visits, most recently at Little Rock, Arkansas, in April 2007. As needed, the board and committees hold additional meetings or teleconference calls to handle necessary business. Semiannually, the board issues a report to Congress that discusses LSC's accomplishments. The board's most recent activities have included the finance committee reviewing financial results and discussing the budget, the annual performance committee completing its performance appraisal of the LSC President and IG, and the operations and regulations committee reviewing the proposed employee handbook, approving the handbook, and providing the handbook to the board for its review and approval.

Board Orientation and Training Do Not Provide Key Information on Oversight and Fiduciary Responsibilities

The LSC board currently has an informal orientation program whereby its members are introduced briefly to the LSC program and legal requirements, but the orientation does not include key information on oversight and fiduciary responsibilities. LSC's orientation program also does not provide specific information on Washington, D.C. law governing nonprofits; the Internal Revenue Service (IRS) regulatory requirements for nonprofit organizations; interpreting LSC's financial statements; managing sensitive documents; FOIA requirements; or travel expenditure limitations. New director training is a basic tool used by well-functioning boards. It takes time for board members to learn about the responsibilities of their positions and the workings of the organization. If board members do not receive a comprehensive orientation about their responsibilities and the unique requirements of the organization they are responsible for directing, then they must learn as they serve, potentially reducing their effectiveness in fulfilling their governance roles and responsibilities as they learn. Current practice for public companies and nonprofit corporations is to provide board members with a broad-based orientation that encompasses the organization's mission, vision, and strategic plan; its history; the members' obligations and performance objectives, and board policies on meetings and attendance; and board member job descriptions, including their performance expectations and their fiduciary obligations. The purpose of such a program is to prepare board members for effectively fulfilling their oversight and governance role in the organization.

Most (7 out of 10) of the current board members, in responding to our survey, indicated that they received orientation or training on their responsibilities as a board member. During interviews, some board

members who had attended orientation said it consisted of a day of individual meetings, which was helpful. Our review of the orientation materials provided to us by management indicated that topics covered included the role of the IG and the General Counsel. During interviews, board members who did and did not receive orientation indicated that LSC could improve board member orientation. For instance, one board member said that the 1-day orientation provided an understanding of what LSC does, but did not necessarily provide general training on how to be a board member.

The LSC board also does not have an ongoing (e.g., annual) training program for its board members. A board needs to stay current with information on changes in governance practices and in its regulatory environment. Additionally, a board needs to be kept up-to-date on key management practices and requirements in such areas as risk assessment and mitigation, internal controls, and financial reporting so that the board can oversee management's key processes. As the environment that a board operates in changes, new issues—whether regulatory, current practice, or industry specific—emerge with the changes. For instance, although most of the requirements of the Sarbanes-Oxley Act of 2002 do not apply to a nonprofit corporation or its board, it has had a significant impact on the operating environment, and many of its requirements have become current practice for nonprofit corporations. An ongoing training program enables a board to stay abreast of current governance practices and fiduciary duties. When we interviewed board members, some noted that they stay current on governance practices by reading materials provided by professional associations, LSC management, or the IG, as well as through seminars they may attend as part of their role on LSC or other boards. While this individual initiative is valuable, board members' experience and knowledge varies, and without an ongoing training program that can equip all members with the same knowledge, board members risk being unable to work together as an efficient and effective body.

LSC's Board Has Not Updated Its Committee Structure to Include Important Committees

A board establishes committees to aid the board's organization and facilitate accomplishing the board's work. Depending upon the board's needs, committees may be either standing (permanent) or ad hoc (for a particular activity). Committees handle specific issues or topics and make policy recommendations for the full board to consider. LSC's board has four standing committees. However, it does not have an audit committee, compensation committee, or ethics/compliance (ethics) committee—all of which are commonly found in public companies and nonprofit

organizations. Table 5 lists LSC’s current board committees and the responsibilities of each committee.

Table 5: Legal Services Corporation Committees and Their Functions

Committee	Functions
Annual performance reviews	<ul style="list-style-type: none"> • Conduct annual performance reviews of the LSC President and IG.
Finance	<ul style="list-style-type: none"> • Assist in the preparation and transmission of appropriations requests. • Recommend an operating budget for LSC and advise on any adjustments. • Provide information as necessary to Congress and the executive branch. • Report to the board on status of appropriations bills or other legislative proposals that may affect LSC. • Recommend to the board procedures and mechanisms for internal audit of expenditures.
Operations and regulations	<ul style="list-style-type: none"> • Recommend proposed bylaws for the board’s consideration and adoption. • Recommend proposed regulations. • Receive reports from counsel on litigation and recommend action to the board. • Report to the board concerning how the board should carry out its future rule making responsibilities. • Address policy questions regarding the corporation’s organizational structure and the internal operations of the corporation, including policies related to personnel.
Provision for the delivery of legal services	<ul style="list-style-type: none"> • Assist the board in implementing Section 1007(g) of the LSC Act, 42 U.S.C. § 2996f(g), by developing proposals for improvements in the provision of legal services to the poor. • Recommend methods for achieving the most efficient and effective delivery of legal services, and assist the board in evaluating the performance of the delivery system. • Address policy issues regarding grant recipient audits, including performance evaluations and compliance monitoring. • Study the special legal needs faced by certain groups. • Address other issues regarding the type, quality, and method of delivering legal services.

Source: GAO based on LSC board resolutions.

Audit Committee

LSC’s board does not have an audit committee, which is a key element in effective corporate governance today. According to the National Council on Nonprofits Association, an audit committee provides independent oversight of the organization’s accounting and financial reporting and oversees the organization’s annual audits. An audit committee is generally responsible for the appointment, compensation, and oversight of the external auditor; handling board communication with the external auditor regarding financial reporting matters; and overseeing the entity’s financial reporting and the adequacy of internal control over financial reporting. The audit committee also serves the important role of assuring the full board of directors that the entity has the appropriate culture, personnel,

policies, systems, and controls in place to safeguard entity assets and to accurately report financial information to internal and external users. Under the Sarbanes-Oxley Act of 2002, public companies are required to have an audit committee made up of independent directors, including at least one financial expert, to oversee the company's financial reporting and audit processes.⁷¹

Although LSC's board has a finance committee, the finance committee's responsibilities do not include those responsibilities required of public company audit committees or those recommended for nonprofit organizations' audit committees. In general, the LSC board's finance committee is responsible for reporting on legislation and LSC's appropriations as well as monitoring LSC's budget. Given LSC's status as a federally funded nonprofit corporation, these are important activities that are appropriately handled by a board-level committee. However, the finance committee's current functions do not include overseeing the audit process or communicating with the auditor about financial reporting matters, which generally are the responsibilities of the IG. The finance committee chair indicated to us that he has had minimal interaction—primarily discussion about the annual meeting presentation—with the independent auditor. New auditing standards⁷² reinforce the importance of communication between the auditor and those overseeing governance of an entity—typically the audit committee representing the board. FDIC, a mixed-ownership U.S. government corporation, which like LSC, has an IG who is responsible for appointing the external auditor, established an audit committee with the responsibility of ensuring that IG recommendations get appropriately implemented by the organization. An audit committee at LSC could enhance the governance structure by representing the board in communicating with the external auditor and the IG, and ensuring that IG recommendations and any weaknesses found during the financial audit process are appropriately addressed by LSC's management. In addition, an audit committee's oversight of LSC's financial reporting on behalf of the board would enhance the board's effectiveness.

⁷¹Pub. L. No. 107-204, §§ 301, 407, 116 Stat. 745, 775, 790 (July 30, 2002), *codified at* 15 U.S.C. §§ 78j-1(m), 7265.

⁷²American Institute of Certified Public Accountants, Statement on Auditing Standard (SAS) No. 112, *Communicating Internal Control Related Matters Identified in an Audit*, effective for financial statements ending on or after December 15, 2006, and No. 114, *The Auditor's Communication With Those Charged With Governance*, effective for financial statements ending on or after December 15, 2006.

Compensation Committee

LSC's board does not have a compensation committee. A compensation committee is an accepted current practice for nonprofit corporations and required for public companies listed on the New York Stock Exchange (NYSE). A compensation committee of a board monitors the compensation structure of the organization. According to the publication *Corporate Governance Best Practices*,⁷³ the compensation committee's responsibilities should include overseeing the organization's compensation structure, policies, and programs; establishing or recommending to the board performance goals and objectives for members of senior management; and establishing or recommending to the independent directors compensation for the chief executive officer. For LSC, this would include approving the LSC President's contract, which includes the length of the contract and amount of compensation, and providing oversight for LSC's compensation and structure. LSC currently does have an annual performance review committee that is responsible for annually evaluating the performance of the LSC President and IG, but it is not responsible for the compensation structure and policies for the organization.

For advice on complex compensation matters, board compensation committees frequently use outside consultants. One such matter is tracking the total cost of senior management's compensation packages so the board has a full understanding of the organization's executive compensation. For LSC, an outside consultant could assist the board in understanding the statutes and regulations that specifically apply to LSC officer and employee compensation. It is also a current practice that the minutes of the compensation committee reflect and record arm's length negotiations with the executive and his or her attorney, including each proposal and counter offer. Current practice also has the internal auditor verify that compensation paid to senior management did not exceed what the board approved.

During our work, we noted that the fiscal year 2006 salaries of all five LSC officers, three LSC OIG personnel (including the IG), and four LSC employees exceeded the statutory compensation limitation. Each affected officer's or employee's total salary in fiscal year 2006 exceeded the annual limitation on the rate of compensation established by the LSC Act as the

⁷³Frederick D. Lipman and L. Keith Lipman, *Corporate Governances Best Practices – Strategies for Public, Private, and Not-for-Profit Organizations* (Hoboken, N.J.: John Wiley & Sons, 2006).

rate of level V of the Executive Schedule. Because the compensation of LSC personnel is limited by the LSC Act to this rate, we questioned why certain personnel received higher rates of pay. LSC officials told us that the total salary included basic pay and a locality pay adjustment. The locality portion of their compensation caused the compensation limitation to be exceeded for the affected LSC personnel.⁷⁴ After we asked LSC officials to justify this practice, they told us that during 2007 LSC's board had engaged outside legal counsel to issue an opinion on whether LSC violated the statutory compensation limitation. In May 2007, the outside counsel issued an opinion to LSC concluding that LSC had not complied with the statutory limitation on the rate of compensation.⁷⁵ We agree with outside counsel's conclusion. Although LSC senior management did not state whether it agrees with the outside counsel's conclusion in its legal opinion, LSC management told us that it is working with the LSC Board of Directors and LSC's appropriations and authorizing committees to take appropriate corrective action.

We also noted that during the board's most recent contract renewal negotiations with LSC's President, the Chairman of the board conducted contract renewal negotiations, based on a delegation of this responsibility from the full board. However, the contract renewal negotiations were conducted before the annual performance committee had given the LSC President her annual review in January 2007 and, thus, without the benefit of information from the performance evaluation. Exceeding the limitations on the annual rate of compensation for certain LSC personnel and conducting negotiations of the president's contract renewal without relevant performance evaluation information could have been avoided with properly designed and implemented procedures for overseeing LSC's compensation structure and policies. Without a properly designed and implemented process for overseeing compensation, LSC remains at risk of not complying with related laws and regulations and engaging in imprudent management practices.

⁷⁴In a September 2006 report to Congress on certain LSC fiscal practices, the LSC IG stated that, after including locality pay, the LSC president's compensation exceeded the compensation limitation and the "authority to pay locality pay over the LSC pay cap" was unclear. Legal Services Corporation, Office of the Inspector General, *Report on Certain Fiscal Practices at the Legal Services Corporation* (Washington, D.C.: Sept. 25, 2006), 26.

⁷⁵According to LSC's general counsel, the outside counsel's legal opinion relied on a Comptroller General opinion, B-279095, June 16, 1998, which dealt with the Washington, D.C., Financial Responsibility and Management Assistance Authority and circumstances similar to those of LSC.

Ethics Committee

While operating in an ethically sensitive environment, the LSC board does not have an ethics committee. An ethics committee is responsible for ensuring that the corporation has systems in place to provide assurance over employee compliance with the corporation's code of conduct and ethics, which LSC also does not have. Ethics is important as a component of the control environment that helps to set the tone at the top of an organization. According to *Standards for Internal Control in the Federal Government*,⁷⁶ a positive control environment includes integrity and ethical values that are provided by leadership through setting and maintaining the organization's ethical tone, providing guidance for proper behavior, removing temptations for unethical behavior, and providing discipline when appropriate. Having an ethics committee on the board is emerging current practice for providing independent oversight over the organization's code of conduct and systems in place to help ensure employee compliance with the code.

In recent years, LSC management has engaged in practices that may have been prevented through effective implementation of strong ethics policies. In September 2006, LSC's OIG issued a report detailing these practices at LSC, based on a request from Congress.⁷⁷ The OIG found that food costs at meetings exceeded per diem allotments by 200 percent and that LSC used funds to pay travel expenses for its president for business related to her positions with outside organizations. The OIG also found that LSC hired acting special counsels from grant recipient organizations causing potential conflicts of interest. The special counsels are responsible for providing LSC management with advice on policy while also being employees of organizations that receive LSC grant money. The OIG—based on a complaint from a confidential source—began investigating one acting special counsel's organization but reported that it had been unable to complete the investigation because the organization had failed to provide documentation required by federal law and LSC grant agreements.⁷⁸ Without the presence of a strong ethics committee providing

⁷⁶[GAO/AIMD-00-21.3.1](#).

⁷⁷Legal Services Corporation, Office of the Inspector General, *Report on Certain Fiscal Practices at the Legal Services Corporation* (Washington, D.C.: Sept. 25, 2006).

⁷⁸Legal Services Corporation, Office of the Inspector General, *Report to the Subcommittee on Commercial and Administrative Law of the House Committee on the Judiciary Regarding Activities of the California Rural League Assistance, Inc.* (Washington, D.C.: Sept. 14, 2006).

effective oversight in the development, implementation, updating, and training for the code of ethics, the corporation is at increased risk of fraud or other ethical misconduct.

The Board and Its Individual Committees Do Not Have Charters

The LSC board and its committees do not have charters that establish their purpose and responsibilities. A charter is used to define the committee's purpose, membership, and members' oversight duties and responsibilities. LSC has a board resolution that provides descriptions of the committees, but the resolution does not contain the elements of a charter and the resolution has not been updated since it was issued in 1995 for three of the four committees. The fourth committee was established in 2003. Current practice is for boards and their committees to each have a written charter that outlines responsibilities, structure, membership criteria, and processes. Current practice also includes reevaluating the charter periodically to see if it needs updating. A charter benefits the board by providing a foundation and focal point for board activities. In addition, the board's activities can periodically be checked against the charter to ensure that they continue to conform to the charter and, if necessary, to update the charter. If the board and committees do not have charters with the appropriate descriptions of their purposes and responsibilities, the board is at increased risk that the board's members will not be effective in carrying out their specific oversight responsibilities.

LSC's Board of Directors Has Not Assessed Its Performance

The LSC board does not assess the board or committee performance collectively, or the individual performance of its board members. A board's self-assessment allows the board to periodically determine whether it is meeting its intended goals and fulfilling its duties and provides information needed by the board to make adjustments to its processes and its oversight of management. Board assessments are common practice for nonprofit corporation boards and a NYSE listing requirement for audit committees of public companies. An assessment can include (1) an overall self-assessment of the entire board, (2) an assessment of the separate board committees, (3) individual board member assessments, or (4) all three. If a board does not assess its performance, it is missing a key opportunity for input from its own members for improving the board's operations and governance policies. A self-assessment enables the board to identify areas for improvement in the board's operating procedures, its committee structure, and its governance practices. Many of the issues we explored during the course of this audit could be evaluated through a board self-assessment. In addition, some board members told us that documents are not provided well enough in

advance to allow a thorough review of the information prior to the meetings or that board members are not receiving the information that they need to fulfill their duties. Such situations could be identified and addressed by the board in a self-assessment. Without a feedback and assessment mechanism, the board runs the risk of not being aware of issues that need to be addressed to improve the board's functioning.

LSC Management Practices Have Not Kept Up with Current Practices for Key Processes in the Areas of Risk Assessment, Internal Control, and Financial Reporting

LSC's management practices have not kept up with current practices in key areas. Specifically, we found that management has neither conducted a risk assessment nor implemented a risk management program to mitigate identified risks, which should include a comprehensive continuity of operations plan (COOP). Risk assessment programs identify the risks the corporation faces and risk mitigation allows management to implement policies that mitigate the risks. A well-designed and tested comprehensive COOP helps mitigate risks from unexpected incidents that can cause great damage and disruptions to operations. Also, senior management has not conducted an assessment of the organization's internal controls and has not evaluated the financial reporting standards that should be used for its financial statements. Internal control assessment and monitoring are important because they provide reasonable assurance that internal control failures will be prevented or promptly detected. Financial reporting standards determine how an organization records its financial transactions and presents the financial statements. Without an internal control assessment and financial reporting standards, LSC management does not have adequate assurance that the assets and operations are protected, that funds are being used appropriately, and that related risks are being mitigated. A key role of the board is to oversee management practices in the areas of risk assessment and mitigation, internal control, and financial reporting.

LSC Management Has Not Thoroughly Assessed Internal Controls or Conducted a Risk Assessment

Management has not completed a thorough assessment of its internal controls or implemented risk mitigation policies in response to a systematic or formal risk assessment. According to the *Standards for Internal Control in the Federal Government*,⁷⁹ internal control should provide for an assessment of the risks the agency faces from both external and internal sources. Management of public companies is required under the Sarbanes-Oxley Act of 2002 to annually assess and report on the

⁷⁹GAO/AIMD-00-21.3.1.

effectiveness of the company's internal controls over financial reporting.⁸⁰ Since fiscal year 2006, management of the 24 CFO Act agencies has also been required by OMB guidance⁸¹ to assess and report on the effectiveness of the agencies' internal controls over financial reporting and compliance with laws and regulations as part of an overall internal control assurance process. As noted earlier, 31 U.S.C. § 3152(c),(d), or FMFIA, required federal agencies to establish internal accounting and administrative control. Assessing and reporting on the effectiveness of internal controls over financial reporting has become an accepted practice among nonprofit corporations.

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.⁸² Internal controls serve as the first line of defense in safeguarding assets and preventing and detecting errors and fraud.

The following are the five standards of internal control, which define elements of internal control and provide the basis against which internal control is to be evaluated.

- Control environment. Management and employees should establish and maintain an environment throughout the organization that sets a positive and supporting attitude toward internal control.
- Risk assessment. Internal control should provide for an assessment of the risks the entity faces from both external and internal sources.
- Control activities. Internal control activities help ensure that management's directives are carried out. The control activities should be effective and efficient in accomplishing the entity's control objectives.
- Information and communication. Information should be recorded and communicated to management and others within the entity who need it and in a form and within a time frame that enables them to carry out their internal control and other responsibilities.

⁸⁰Pub. L. No. 107-204, § 404, 116 Stat. 745, 789 (July 30, 2002), *codified at* 15 U.S.C. § 7262.

⁸¹OMB Circular No. A-123, *Management's Responsibility for Internal Control* (rev. Dec. 21, 2004).

⁸²[GAO/AIMD-00-21.3.1](#).

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- **Monitoring.** Internal control monitoring should assess the quality of performance over time and ensure that the findings of audits and other reviews are properly resolved.

The chief executive officer generally has primary responsibility for risk assessment and risk management under the direction of the board of directors. A risk assessment process includes such areas as operations, compliance, and financial reporting, in which management comprehensively identifies risks, and considers significant interactions between the entity and external parties as well as internal risks at both the entitywide and activity level. Risk assessment is also an integral part of the Committee of Sponsoring Organizations of the Treadway Commission internal control framework⁸³ and an entity's effective implementation of internal controls. All entities, regardless of size, structure, nature, or industry, encounter risks at all levels within their organizations. Through the risk assessment process, management determines how much risk is to be prudently accepted and strives to maintain risk within these levels.

Auditing standards that became effective on or after December 15, 2006,⁸⁴ cite ineffective oversight of the entity's financial reporting and internal control by those charged with governance, as well as an ineffective control environment, as indicators of control deficiencies and strong indicators of material weaknesses in internal control. The standards include the following examples of deficiencies in the design of controls that may be control deficiencies, significant deficiencies, or material weaknesses that would be reported by the auditor: (1) inadequate documentation of the components of internal control, (2) inadequate design of monitoring controls used to assess the design and operating effectiveness of the entity's internal control over time, and (3) the absence of an internal process to report deficiencies in internal control to management on a timely basis.

⁸³Committee of Sponsoring Organizations of the Treadway Commission, *Internal Control – Integrated Framework* (1992 and 1994).

⁸⁴American Institute of Certified Public Accountants, Statement of Auditing Standards No. 112, *Communicating Internal Control Related Matters Identified in an Audit*, and Statement of Auditing Standards No. 114, *The Auditor's Communication with Those Charged with Governance*.

According to LSC management, it relies on a cycle memorandum⁸⁵ prepared by LSC's external auditor as management's assessment of internal controls. However, the cycle memorandum contains process descriptions and does not identify internal controls, their objectives, or the assertions (completeness, rights and obligations, valuation, existence, and presentation and disclosure) that the controls are intended to ensure and the risks that need to be addressed through controls. LSC's Treasurer/Controller told us that LSC management has not conducted its own formal assessment of internal controls. The Treasurer does conduct ongoing, informal assessments of certain financial processes on an ad hoc basis. However, these assessments are not utilized as part of a comprehensive internal control evaluation. Without comprehensive internal control assessment and monitoring, LSC is at risk that it will not prevent or promptly detect internal control failures, including unauthorized or improper use of federal funds or violations of laws or regulations in its operations.

Code of Conduct and Ethics

LSC currently does not have a code of conduct that establishes a conflict-of-interest or ethics policy for its employees. A conflict-of-interest policy is intended to help ensure that when actual or potential conflicts of interest arise, the organization has a process in place under which the affected individual will recognize the potential conflict and advise management or the governing body about the relevant facts so that potential conflicts of interest can be resolved. Ethics provisions in the LSC Act⁸⁶ and elaborated on in the LSC bylaws (§ 3.05) pertain only to the outside interests of the Board of Directors. LSC bylaws give the board authority to adopt rules and regulations regarding the conduct of officers and employees in matters of any adverse interest to LSC. At the time of our review, the only conflict-of-interest policy affecting employees was a prohibition against gifts, fees, and honoraria greater than \$50. LSC policy also states that officers of the corporation must have any outside compensation approved by the board.

Federal employees are subject to various statutes and regulations that govern ethical conduct, including public financial disclosure requirements

⁸⁵ A cycle memorandum documents a significant accounting process, such as revenue or purchasing, and includes the significant accounting application, financial statements line items, general ledger accounts, and the policies and procedures related to the cycle being documented.

⁸⁶ LSC Act, 42 U.S.C. § 2996d(c).

and outside earned income and activities limitations under the Ethics in Government Act of 1978, as amended,⁸⁷ and restrictions on gifts to federal employees and acceptance of travel and related expenses from nonfederal sources enacted by the Ethics Reform Act of 1989.⁸⁸ The Office of Government Ethics provides leadership for executive branch agencies and departments to prevent conflicts of interest on the part of government employees and to resolve conflicts that do arise.

The NYSE and the other stock exchanges have adopted corporate governance requirements to aid their listed companies in complying with ethics requirements contained in the Sarbanes-Oxley Act of 2002.⁸⁹ NYSE-listed companies must adopt codes of business conduct and ethics for directors, officers, and employees, and post the codes on their Web sites. Under the Sarbanes-Oxley Act and the related implementation guidance, codes of conduct and ethics should address conflicts of interest, confidentiality, protection and proper use of an organization's assets, and compliance with laws and regulations, and encourage reporting of illegal or unethical behavior. The American Bar Association (ABA) encourages nonprofit organizations to adopt similar policies.

During the LSC operations and regulations committee meeting in April 2007, a board member suggested that a future agenda item should be development of a compliance program that includes a code of conduct. Without such a program that includes conflict-of-interest and ethics policies, LSC is at risk of personnel being unaware of their responsibility in the area of ethics and conflicts of interest, including incidents of illegal or unethical behavior occurring and not being detected.

LSC Management Has Not Designed and Implemented a Comprehensive Continuity of Operations Plan

Although LSC does have a COOP, the plan is not complete or comprehensive. It is the policy of the U.S. government for each agency to have in place a comprehensive and effective program to ensure the continuity of essential federal functions under all circumstances. Today's changing threat environment and the potential for no-notice emergencies,

⁸⁷5 U.S.C. appx. §§ 101-111, 501-505.

⁸⁸5 U.S.C. § 7353; 31 U.S.C. § 1353.

⁸⁹Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 406, 116 Stat. 747, 789-90 (July 30, 2002).

including localized acts of nature, accidents, technological emergencies, and terrorist attacks, have increased the need for COOP capabilities. In this environment, preparing for disasters is an integral part of mitigating risk. Federal Preparedness Circular No. 65 identifies the required characteristics of an effective COOP program, which includes maintaining and testing plans for responding to likely catastrophic events.

LSC's Office of Information Technology (OIT) does perform a full, weekly backup of data and an incremental daily backup. At the end of each month, the most recent full weekly backup is stored off site; the most recent 12 months are retained. According to LSC's current COOP description provided by LSC, OIT would need to relocate its systems to a remote location should the LSC building not be accessible. Also, from this description, it appears that system hardware first needs to be retrieved from the LSC building and then transported and installed in another location. However, there is no specific implementation plan or remote location specified in the plan. LSC provided us with meeting agendas from May 2006 and June 2006 regarding emergency responses, but did not provide any additional COOP program information. Furthermore, there is no indication that OIT conducted any simulations of disruptions to test its established plans. An organization that does not have a tested, comprehensive COOP is vulnerable to unexpected incidents capable of causing great damage. Finally, because LSC does not have a comprehensive risk assessment process, management and the board have not assessed the risks or identified the acceptable levels of risk associated with LSC's current COOP.

LSC Management Has Not Assessed the Propriety of Its Financial Reporting Standards

LSC's management has not conducted its own assessment or analysis to determine which set of accounting standards—those promulgated by the Financial Accounting Standards Board (FASB), Government Accounting Standards Board (GASB), or Federal Accounting Standards Advisory Board—are most applicable for LSC to use. The accounting standards that an entity uses determine how the entity records its financial transactions and how the entity presents the financial statements. According to LSC management, in the mid-1990s, the former IG determined that LSC's financial reporting should follow the standards issued by GASB, which establishes standards of financial accounting and reporting for state and local governmental entities. However, management, not the OIG, is responsible for the financial statements and for adopting the related accounting policies and for maintaining an adequate and effective system of accounts that will, among other things, help ensure the production of proper financial statements.

In response to our inquiries about LSC's selection and use of those standards in its accounting and preparation of its financial statements, neither LSC management nor the current IG were able to provide us with an analysis or the primary technical reasons why LSC is currently using GASB standards, which are normally intended for use by state and local governments. During the April 2007 meeting of the finance committee, a discussion was held on whether the corporation should be using GASB or FASB standards for its accounting. The Treasurer informed the committee members that his current opinion was that LSC should be using the FASB standard, instead of GASB. It was agreed that further discussion would take place between the Treasurer and OIG staff and that the committee would receive an update at the next committee meeting in July 2007.

Conclusions

In recent years, governance and accountability processes have received increased scrutiny and emphasis in the nonprofit, federal agency, and public company sectors as a result of governance and accountability breakdowns, most notably in the public company financial scandals that led to the enactment of the Sarbanes-Oxley Act of 2002. Public companies now operate under strengthened governance and accountability standards, including requirements for ethics policies and improved internal controls. The federal government and nonprofit sectors have followed this lead and established new standards and requirements for improved internal control reporting and governance and accountability. For nonprofit corporations using funding from taxpayers and donors, effective governance, accountability, and internal control are key to maintaining trust and credibility. Governance and accountability breakdowns result in a lack of trust from donors, grantors, and appropriators, which could ultimately put funding and the organization's credibility at risk.

Since its inception over 30 years ago, LSC's governance and accountability requirements, including its financial reporting and internal control, have not changed significantly. Further, LSC's board and management have not kept pace with evolving governance and accountability practices. As a result, LSC's current practices have fallen behind those of federal agencies, U.S. government corporations, and other nonprofit corporations. The current accepted practices of federal agencies, U.S. government corporations, and nonprofit corporations provide a framework for identifying standards that can most effectively be used for strengthening LSC's governance and accountability. Effectively utilized, current, accepted governance and accountability practices are necessary to provide strong board oversight and effective day-to-day management of LSC's performance. In addition, NYSE listing standards and the

Conference Board provide widely accepted governance standards that can be applied to public companies and nonprofit corporations to improve governance structures and practices. Because LSC's board and management have not kept pace with the modernization of practices in federal entities and other nonprofit corporations, many opportunities exist to improve and modernize existing processes. By updating and strengthening its governance and accountability structures, LSC can increase assurance that federal funds are being properly spent and its operations are effectively carried out to meet its mission.

Matter for Congressional Consideration

Since the LSC Act was enacted in 1974 and last comprehensively amended and reauthorized in 1977, new laws governing federal agencies, U.S. government corporations, and public companies have been enacted to strengthen governance and accountability requirements. Therefore, Congress should consider whether LSC could benefit from additional legislatively mandated governance and accountability requirements, such as financial reporting and internal control requirements, modeled after what has worked successfully at federal agencies or U.S. government corporations. There are different options available to Congress for such a mandate.

- Congress could maintain LSC's current organizational structure as a federally chartered and federally funded, private, nonmembership, and tax-exempt D.C. nonprofit corporation and enact permanent legislation to require LSC to implement additional governance and accountability requirements.
- Alternatively, Congress could enact legislation to convert LSC to a federal entity (such as a U.S. government corporation subject to the Government Corporation Control Act) or an independent federal agency that is required to follow the same laws and regulations as executive branch agencies. In the statute establishing LSC as a federal entity, Congress could specifically exempt LSC from certain requirements that would otherwise apply to that type of federal entity in order to further special policy considerations particular to LSC.

Recommendations

Through our evaluation of LSC's governance and accountability practices, we identified opportunities for the LSC board and management to improve their current governance and accountability practices.

Recommendations for Board Action

In order to improve and modernize the governance processes and structure of LSC, we recommend that the LSC Board of Directors take the following eight actions:

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- establish and implement a comprehensive orientation program for new board members to include key topics such as fiduciary duties, IRS requirements, and interpretation of the financial statements;
 - develop a plan for providing a regular training program for board members that includes providing updates or changes in LSC's operating environment and relevant governance and accountability practices;
 - establish an audit committee function to provide oversight to LSC's financial reporting and audit processes either through creating a separate audit committee or by rewriting the charter of its finance committee;
 - establish a compensation committee function to oversee compensation matters involving LSC officers and overall compensation structure either through creating a separate compensation committee or by rewriting the charter of its annual performance review committee;
 - establish charters for the Board of Directors and all existing and any newly developed committees to clearly establish committees' purposes, duties, and responsibilities;
 - implement a periodic self-assessment of the board's, the committees', and each individual member's performance for purposes of evaluating whether improvements can be made to the board's structure and processes;
 - develop and implement procedures to periodically evaluate key management processes, including at a minimum, processes for risk assessment and mitigation, internal control, and financial reporting; and
 - establish a shorter time frame (e.g., 60 days) for issuing LSC's audited financial statements.

Recommendations for Executive Action

In order to improve and modernize key management processes at LSC, the president and executive committee should take the following four actions:

- conduct and document a risk assessment and implement a corresponding risk management program as part of a comprehensive evaluation of internal control;
- with the board's oversight, evaluate and document relevant requirements of the Sarbanes-Oxley Act of 2002 and practices of NYSE and ABA that are used to establish a comprehensive code of conduct, including ethics and conflict-of-interest policies and procedures for employees and officers of the corporation;
- establish a comprehensive and effective COOP program, including conducting a simulation to test the established program; and
- conduct an evaluation to determine whether GASB should be adopted as a financial reporting standard for LSC's annual financial statements.

Agency Comments and Our Evaluation

We provided copies of the draft report to LSC’s Board of Directors and management for comment prior to finalizing the report. We received written comment letters from the Chairman on behalf of LSC’s Board of Directors and LSC’s President on behalf of LSC’s management (see apps. V and VI). Both the Chairman and President expressed their commitment to achieving strong governance and accountability and outlined the actions that LSC’s board and management plan to take in response to our recommendations. LSC management provided technical comments that were incorporated into the report as appropriate.

The Chairman of LSC’s board expressed the board’s agreement to take action to address each of the recommendations we made to the board. LSC’s president on behalf of management provided a comment letter where management fully agreed with our recommendations dealing with financial reporting standards, COOP, and code of conduct, and expressed commitment to further action “in the spirit of” our recommendation dealing with conducting and documenting a risk assessment and implementing a corresponding risk management program as part of a comprehensive evaluation of internal control.

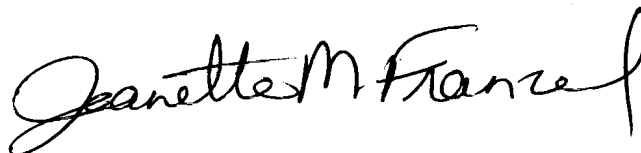
LSC’s President also included some clarifications to our draft report. First, LSC management stated that “the draft report does not address the existence of congressional oversight,” and provided additional context regarding LSC’s congressional oversight. Our draft report included a discussion of congressional oversight through LSC’s budget process and the appropriations process. In our final report, we included a broader description of LSC’s congressional oversight. Second, LSC management points out that LSC provides certain whistleblower protection statements in its employee handbook regarding communicating with the OIG. We added language to our final report to reflect the existence of such protection under the IG Act. Third, the LSC President stated that the OIG did not find conflicts of interest related to the acting special counsel and was troubled by the references in our report to potential conflicts of interest. In our report, we included information about the IG’s finding that LSC’s hiring of acting special counsels from grantee organizations represented a potential conflict of interest. Our report also noted that the board currently does not have an ethics committee and there is no code of conduct for LSC employees.

Both LSC’s Chairman and President commented on the matter that we presented for congressional consideration—that Congress should consider whether LSC could benefit from additional legislatively mandated governance and accountability requirements. In addition, in their

respective letters, LSC's Chairman and President both provided their views that LSC's governing statutes are appropriate and have worked well and stated that many of the governance recommendations could be accomplished without changing the statutory framework of LSC. As we noted, Congress chartered LSC over 30 years ago as a private corporation for certain policy reasons with governance and accountability requirements that existed at that time as a unique private corporation in response to certain policy considerations. While federal agencies and government corporations have been subject to strengthened governance and accountability requirements over recent years, LSC has not kept up with evolving reforms aimed at strengthening internal control over an organization's financial reporting process and systems, with LSC's board's practices falling short of modern board practices and LSC not keeping up with current management practices. Therefore, we presented the options of amending LSC's governing statutes to improve governance and accountability requirements or converting LSC to a federal entity, which would include compliance with related governance and accountability requirements.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. We will then send copies to other appropriate congressional committees, the president of LSC, and the LSC Board of Directors. We will also make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staff have any questions concerning this report, please contact me at (202) 512-9471 or franzelj@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix VII.



Jeanette M. Franzel
Director, Financial Management
and Assurance

List of Requesters

The Honorable Edward M. Kennedy
Chairman

The Honorable Michael E. Enzi
Ranking Member
Committee on Health, Education, Labor, and Pensions
United States Senate

The Honorable Charles E. Grassley
Ranking Member
Committee on Finance
United States Senate

The Honorable Chris Cannon
Ranking Member
Subcommittee on Commercial and Administrative Law
Committee on the Judiciary
House of Representatives

The Honorable F. James Sensenbrenner, Jr.
House of Representatives

Appendix I: Origin and Creation of the Legal Services Corporation

Although low-income people since the 19th century had been turning to local legal aid societies throughout the United States for assistance with their civil legal problems, in the 1960s President Lyndon B. Johnson declared poverty to be a national problem and initiated a “War on Poverty” to make federal resources available to support local antipoverty programs, such as the legal assistance provided by legal aid societies. The first War on Poverty legislation, the Economic Opportunity Act of 1964,¹ established the now-defunct Office of Economic Opportunity (OEO) within the Executive Office of the President to administer the War on Poverty programs, including what would become the Legal Services Program, the predecessor to the current Legal Services Corporation (LSC).

The OEO’s Legal Services Program activities soon generated political controversy, and by the early 1970s there was a general consensus that the OEO’s Legal Services Program should be moved out of the Executive Office of the President.² A number of different structures were proposed.³ For example, there were proposals to move the Legal Services Program into an executive department, such as the Department of Justice, the Department of Housing and Urban Development, or the predecessor to the current Department of Health and Human Services. In addition to raising concerns about political interference, critics of placing the function in an executive department raised concerns about decreased program visibility, reduced responsiveness to client needs, and the objectives of the program being subordinated to the department’s mission. Another proposed organizational home was the Judiciary, especially the Administrative Office of the United States Courts, but critics argued that the Judiciary was already overburdened with work and faced frequent funding problems.

Four alternative organizational structures were suggested that took into consideration accountability to Congress and the public while promoting political independence, permanence, program stability, operational

¹Economic Opportunity Act of 1964, Pub. L. No. 88-452, 78 Stat. 508 (Aug. 20, 1964).

²See, e.g., H. Rep. No. 93-247 (June 4, 1963), 1974 U.S.C.A.A.N. 3872, 3873-75 (report on H.R. 7824, a bill to establish an independent corporation to replace the Legal Services Program).

³See, e.g., *The Legal Services Corporation: Curtailing Political Influence*, 81 Yale L. J. 231, 261 n. 106 (1971-72), which cites American Bar Association, *Joint Information Report: The Corporation for Legal Services* (1971), and Edgar Cahn and Jean Cahn, *Legal Services: Alternative Organizational Models*. Report to the President’s Advisory Council on Executive Organization (June 9, 1970).

flexibility, and attorney independence to represent clients consistent with high professional standards. The four alternative organizational structures proposed were a federal block grant program, an independent agency in the executive branch, a U.S. government corporation, or a private nonprofit corporation. Examples of such organizations today include, respectively, (1) the Temporary Assistance for Needy Families Program and the Community Development Block Grant Program, (2) the National Science Foundation and the National Foundation on the Arts and the Humanities, (3) the Millennium Challenge Corporation and the Corporation for National and Community Service (AmeriCorps), and (4) the Corporation for Public Broadcasting (CPB).

Ultimately, consensus in the early 1970s coalesced around an entity modeled after the CPB, which was a private, nonmembership, nonprofit corporation in the District of Columbia with federal funding that was federally chartered by the Public Broadcasting Act of 1967⁴ to “facilitate the development of public telecommunications and to afford maximum protection from extraneous interference and control.” The CPB federal charter created a nine-member, bipartisan board of directors that is appointed by the President of the United States with the advice and consent of the U.S. Senate. The board manages⁵ CPB to accomplish its primary mission of providing federal funding via grants and contracts to public telecommunications and production entities in order to promote the expansion and development of public telecommunications with high-quality, diverse programming responsive to local needs and furthering instructional, educational, and cultural purposes. CPB, which was last reauthorized in 1992,⁶ is also funded through annual appropriations.

⁴Public Broadcasting Act of 1967, Pub. L. No. 90-129, tit. II, 81 Stat. 365, 367-73 (Nov. 7, 1967), *codified, as amended, at* 52 U.S.C. § 396.

⁵The D.C. Nonprofit Corporation Act vests the board of directors with responsibility for managing the affairs of the corporation, but permits the board to delegate some of this responsibility to officers or other agents. *See* D.C. Code §§ 29-301.18, 29-301.24(d). Many boards delegate day-to-day duties but retain the oversight duties of the management function.

⁶Public Telecommunications Act of 1992, Pub. L. No. 102-356, § 8106, 106 Stat. 949, 951 (Aug. 26, 1992), *codified at* 47 U.S.C. § 396(k)(1)(C). The 1992 act authorized funding levels through fiscal year 1996. Since then, CPB has been funded in annual appropriations acts, which have provided 2-year advanced funding. Thus, for example, CPB was appropriated funding for fiscal year 2008 in the fiscal year 2006 appropriations act. *See* Departments of Labor, Health and Human Services, and Education, and Related Agencies Appropriations Act, 2006, Pub. L. No. 109-149, 119 Stat. 2833, 2874 (Dec. 30, 2005).

By transferring the Legal Services Program to a federally funded, private nonprofit corporation modeled after CPB, supporters of this type of organizational entity hoped to achieve the goal of greater operational flexibility and protection from political pressure from all levels of government while retaining accountability to Congress and the public. Supporters also hoped to encourage private donations to LSC, so unlike CPB's federal charter, the Legal Services Corporation Act of 1974 (LSC Act) provides that LSC shall be eligible to be treated as a charitable corporation exempt from federal taxation.

Under the Internal Revenue Code, tax-exempt status basically means that the corporation is operated and organized exclusively for charitable purposes, does not attempt to influence legislation, does not campaign on behalf of candidates for public office, and does not allow any of its net inure earnings to inure to the benefit of any individual.⁷ To maintain tax-exempt status, organizations must annually file with the Internal Revenue Service (IRS) a Form 990, Return of Organization Exempt From Income Tax, which is available for public inspection and includes such information as the organization's gross income, assets and liabilities, and compensation paid to high-level managers.⁸ A number of the provisions in the LSC Act are consistent with IRS's requirements for tax-exempt status. For example, the LSC Act's purpose of providing civil legal assistance to low-income people qualifies as charitable, and the LSC Act prohibits LSC from engaging in certain political activities, such as activities that would influence the passage or defeat of any legislation at the local, state, or federal level or from making LSC resources available to support any political party or campaign of any candidate for public office. The LSC Act also states that LSC has no power to issue stocks and prohibits any LSC income or assets from inuring to the benefit of any director, officer, or employee, except as reasonable compensation for services or reimbursement for expenses. By making and keeping LSC a tax-exempt organization, the LSC Act prevents federal tax dollars from being spent on paying federal taxes and thus permits LSC to use its funds for the charitable purpose set out in the LSC Act.⁹

⁷See 26 U.S.C. §§ 170(c)(2), 501(a), 501(c)(3); 26 C.F.R. §§ 1.501(a)-1, 1.501(c)(3)-1.

⁸See 26 U.S.C. §§ 6104, 6033.

⁹See, e.g., Warren E. George, *Development of the Legal Services Corporation*, 61 Cornell L. Rev. 681 (1975-76).

Congress enacted the LSC Act in 1974 to transfer the functions of the Legal Services Program from the Executive Office of the President into a private, nonmembership, nonprofit corporation with tax-exempt status that would be federally chartered in the District of Columbia and be authorized to receive annual federal appropriations to fund its operations supporting civil legal assistance to low-income people in communities throughout the United States.

Appendix II: Examples of Corporate Governance Guidelines

Corporate practices	Corporate governance guidelines
Board's fiduciary duties	<p>In carrying out their functions, corporate directors must fulfill fiduciary duties of care, loyalty, and good faith. Boards may delegate the day-to-day management of the company to the chief executive officer (CEO) and other senior management, but board members retain responsibilities for oversight and monitoring of any delegated functions.</p> <p>Under state corporate law, directors owe fiduciary duties to the corporation and its shareholders:</p> <ul style="list-style-type: none"> • the <i>duty of care</i>, which is the duty to exercise appropriate diligence and make decisions that are informed; • the <i>duty of loyalty</i>, which is the duty to act without conflict and always put the interests of the corporation before those of the individual director or other individuals or organizations the individual director is affiliated with; and • the <i>duty to act in good faith</i>, which is the duty to act with honesty of purpose and in accordance with evolving corporate governance best practices.
Roles of board and management clearly defined	<p>A strong and effective board of directors should have a clear view of its role in relationship to management. How the board organizes itself and structures its processes will vary with the nature of the business, business strategy, the size and maturity of the company, and the talents and personalities of the CEO and directors. Circumstances particular to the corporate culture may also influence the board's role. The board focuses principally on guidance and strategic issues, the selection of the CEO and other senior executives, risk oversight and performance assessment, and adherence to legal requirements. Management implements the business strategy and runs the company's day-to-day operations with the goal of increasing shareholder value for the long term.</p>
Corporate governance guidelines in place	<p>The board should have a set of written guidelines in place to articulate corporate governance principles and the roles and responsibilities of the board and management. These guidelines should be reviewed at least annually. By elaborating on directors' basic duties, the guidelines help the board and its individual members understand their obligations as well as the general boundaries within which they should operate.</p>

**Appendix II: Examples of Corporate
Governance Guidelines**

Corporate practices	Corporate governance guidelines
Board access to information and conduct of board meetings	<p>The effectiveness of the board ultimately depends on the quality and timeliness of information received by directors. Each board and management should agree on the type of information the board needs to make informed decisions and perform its oversight function. This should include material on business and financial performance, strategic issues, and information about material risks and other significant matter facing the company. Information for board meetings should be distributed enough in advance of the meetings to permit directors to read, absorb, and consider it. Besides formal processes, board and management should develop informal communication and reporting channels.</p> <p>Boards should consider the following best practices to help ensure effective decision making and exchange of information and ideas at meetings of the full board or its committees:</p> <ul style="list-style-type: none">• Independent directors should be able to place issues on the board agenda, with time for adequate discussion and consideration, and determine the type and quality of information flow required for effective board action. Last minute add-ons to the agenda, especially for weighty issues, should be discouraged.• The lead/presiding director, if there is one, should take responsibility to surfacing issues that impact the business and need to be presented to the board for discussion and/or action, whether in regular or executive sessions.• Management should provide information that effectively explains the company's operating and financial status, as well as other significant issues facing the company and the board. Appropriate feedback mechanisms between management and the board should be developed to ensure that the materials are useful, timely, and of adequate depth. Meeting materials should contain a cover letter highlighting the most important issues for directors' consideration.• Meetings should be structured to encourage participation and dialogue among the directors.• Directors have an obligation to ensure near-perfect attendance at meetings and actively participate in the meetings, including asking the hard questions.• The CEO should expose directors to senior management team members and operation (line) management at meetings and field trips so that directors can, with knowledge informally acquired from management, further delve into issues necessary to carry out their functions. <p><i>According to New York Stock Exchange (NYSE) rules, executive sessions should</i></p> <ol style="list-style-type: none">1. be held without management present;2. be regularly scheduled to prevent negative inferences;3. disclose the name of the director presiding at the executive sessions, if one is chosen, in the annual proxy statement or the procedure by which the director presiding at meetings is selected; and4. disclose mechanisms for interested parties to make their concerns known to the nonmanagement directors as a group. NASDAQ's rules require regularly convened executive sessions of the independent directors. <p><i>In addition, according to best practices identified by the Conference Board Directors' Institute, executive sessions should</i></p> <ul style="list-style-type: none">• promote open dialogue among the independent members and free exchange of ideas, perspectives, and information;• have a feedback mechanism to the CEO for important issues that may surface (the lead or presiding director can take the lead in providing the CEO feedback);• be scheduled at regular intervals (most commonly following each full board meeting, even though some boards may also hold a short pre-meeting executive session) to eliminate any negative inferences from convening these sessions; and• be supplemented by additional off-line informational channels (such as dinners before board meetings) to help build trust and relationships among the independent directors.

**Appendix II: Examples of Corporate
Governance Guidelines**

Corporate practices	Corporate governance guidelines
Board independence	<p>An independent, vigorous, and diligent board of directors is crucial to good corporate governance. Boards must move from their traditional advisory roles to become active fiduciaries in the exercise of their oversight responsibilities. From this standpoint, independence is essential. Although defined by legislative and regulatory standards, a director's independence (in thought and action) from management influence should always be evaluated qualitatively and on a case-by-case basis.</p> <p>For the past few years, issuers have been required to disclose information in Securities and Exchange Commission filings regarding director independence and other corporate governance matters. The commission has recently consolidated these requirements under new Item 407 of Regulation S-K. Registrants must disclose information about director independence; nominating, audit, and compensation committees; and shareholder communications by the following means:</p> <ul style="list-style-type: none"> • Identifying each independent director of the company (and the nominees for director when the information is being presented in a proxy or information statements) as measured by the company's definition of independence. • Identifying any members of the compensation, nominating, and audit committees whom the company has not identified as independent under such definition. • Describing, by specific category or type, any related party transactions, relationships, or arrangements <i>not</i> disclosed pursuant to Item 404 that were part of the board of directors' consideration in determining that the independence standard has been met as to each independent director or director nominee. • Providing the number of board meetings during the fiscal year and certain attendance information, including the board's policy on attendance at annual shareholder meetings and attendance information with respect to the last annual meeting. • Identifying any standing audit, nominating, and compensation committees; their membership composition; and the number of meetings, together with certain descriptive information regarding such committees. • Disclosing information about the audit committee's independence and expertise, and about the process for shareholders to send communications to the registrant's board of directors. If there is no process, the basis for the board's view that it is appropriate not to have such a process and, if all shareholder communications are not sent directly to board members, a description of the process for determining which communications will be provided to board members.
Board composition, size, and director qualifications	<p>The composition and skill set of a board should be linked to the company's particular challenges and strategic vision. As companies develop and experience changed circumstances, the desired composition of the board may be different and should be reviewed.</p> <p>The composition of the board should be tailored to meet the needs of the company and its stage of development. There should be a mix of director knowledge and expertise in</p> <ul style="list-style-type: none"> • accounting and finance, • risk management, • strategic and business planning, • legal and compliance, • human resources, • marketing, • technology, • international markets, and • industry knowledge.

**Appendix II: Examples of Corporate
Governance Guidelines**

Corporate practices

Corporate governance guidelines

As with any group working together, boardroom relationships are difficult to predict, but an effective director

- asks the hard questions,
- works well with others,
- possesses valuable input,
- is available when needed,
- is alert and inquisitive,
- has business knowledge,
- contributes to committee work,
- attends meetings,
- challenges management's assumptions when needed and speaks out appropriately at board meeting,
- prepares for meetings,
- makes contributions to long-range planning, and
- provides an overall contribution to the board and committees on which he or she serves.

According to the 2006 edition of the annual *Directors' Compensation and Board Practices* report by the Conference Board, the median board size, depending on the industry, ranges from 9 to 11 members. The median number for outside directors varies from 8 to 10. The 2007 edition of *Board Practices/Board Pay* report noted that 72 percent of Standards & Poor's 1,500 companies had 9-member boards in 2005, down from 12 in 2003. Boards need to be large enough to accommodate the necessary skill sets, but still small enough to promote cohesion, flexibility, and effective participation. "When you've got a 20- or 30-person corporate board," argued one member of the Conference Board Directors' Institute, "it's one way of ensuring that nothing is ever going to happen that the CEO doesn't want to happen. If you've got a small board—8 to 10 people—people do get involved."

The NYSE requires that a list of director qualification standards be included in the company's corporate governance guidelines. These standards should, at a minimum, reflect the NYSE independence requirements. Companies may also address other substantive qualifications requirements, including policies limiting the number of boards on which a director may sit and specifying director tenure, retirement, and succession criteria. All directors must devote the proper amount of time and attention to develop the broad-based and specific knowledge required to fulfill their obligations.

In order to ensure a high level of commitment, directors should

- assess carefully and guard against potential entanglements, such as service on an excessive number of boards;
 - prepare for and attend all board and committee meetings and consider travel requirements for these meetings (in particular for foreign-based directors);
 - participate actively and effectively at meetings;
 - develop and maintain a high level of knowledge about the company's business;
 - keep current in the director's own specific field of expertise; and
 - develop broad knowledge about the role and responsibilities of directors, including legal responsibilities.
-

**Appendix II: Examples of Corporate
Governance Guidelines**

Corporate practices	Corporate governance guidelines
Board leadership	<p>Boards should adopt a structure providing nonmanagement directors with the leadership necessary for them to act independently and perform effectively. This structure could include separating the positions of chairman and CEO; creating a lead independent director; or in case of a former employee acting as chairman, appointing a presiding director from among the independent directors.</p> <p>Any structural alternative a board wishes to adopt should</p> <ul style="list-style-type: none">• strengthen the independence and oversight role of the board,• provide the nonmanagement directors with the ultimate authority over information flow to the board, and• improve the relationship and flow of information between the board, CEO, and senior management.
Board committee structure	<p>Boards should establish committees (e.g., nominating/governance, audit, compensation) that will enhance the overall effectiveness of the board by ensuring focus on and oversight of matters of particular concern. Statutory law, SEC rules, and stock exchange listing standards require that committees must be composed solely of directors who meet specified independence standards.</p> <p><i>An effective committee structure should require that</i></p> <ul style="list-style-type: none">• each committee have a charter delineating the committee’s jurisdiction, duties, and responsibilities;• each charter include only duties that can actually be accomplished; and• each charter be reviewed at least annually.
Succession planning and leadership development	<p>Hiring the CEO and planning for CEO succession are two of the most important responsibilities of the board. The board should institute a CEO succession plan and selection process overseen by one of its independent committees or by a designated director or group of directors.</p> <p><i>A successful succession planning process will</i></p> <ul style="list-style-type: none">• be continuous,• be driven and controlled by the board,• involve inputs from the CEO and other key employees,• be easily executed in the event of a crisis,• be tied to the corporate strategy,• be geared toward finding the right leader at the right time,• develop talent pools throughout the managerial ranks of the company, and• avoid a “horse race” mentality that may lead to the loss of key officers when the new CEO is chosen.

Source: Reproduced by permission from Matteo Tomello and Carolyn K. Brancato, *Corporate Governance Handbook, 2007: Legal Standards and Board Practices* (New York, N.Y.: 2007).

Appendix III: Comparison of Other Key LSC Requirements

Grants Management

LSC is subject to grants management requirements that are stronger than those of other Washington, D.C., nonprofit corporations, but somewhat less rigorous than those governing federal entities, including requirements related to the grantor's audits of grant recipients, administration of grants, and application of cost principles to grants. (See table 6.) In 1996, Congress amended the LSC Act on a fiscal year basis through certain administrative provisions included in the fiscal year 1996 appropriations act for LSC (LSC 1996 Amendments).¹ The LSC Act requires the LSC board to ensure that each grant recipient is subject to an annual financial audit and to maintain a copy of that audit report at its headquarters for at least 5 years. The LSC 1996 Amendments added additional requirements related to grant recipient audits.² The LSC 1996 Amendments require the grant recipient audit to be conducted in accordance with generally accepted government auditing standards (GAGAS) and guidance established by the LSC Office of Inspector General (OIG). The grant recipient audit report must state whether (1) the grant recipient's financial statements fairly present its financial position and results of operations in accordance with generally accepted accounting principles (GAAP); (2) the grant recipient has internal control systems that provide reasonable assurance that it is managing its funds, LSC and otherwise, in compliance with federal laws and regulations; and (3) that the grant recipient has complied with federal laws and regulations applicable to funds received from LSC or other sources.

¹With only minor changes, the text of these amendments has been reenacted in each subsequent fiscal year's LSC appropriations act.

²Department of State and Related Agencies Appropriations Act, 1996 (1996 Appropriations Act), Pub. L. No. 104-134, tit. IV, § 509(a), 110 Stat. 1321 (Apr. 26, 1996).

Table 6: Key Statutory Provisions for Grants Management

	LSC	Independent federal agencies	U.S. government corporations	D.C. nonprofit corporations
Audits of grant recipients	1996 LSC Amendments	Single Audit Act; OMB Cir. No. A-133 on audits of grant recipients	Single Audit Act; OMB Cir. No. A-133 on audits of grant recipients	None
Grant management requirements	1996 LSC Amendments	OMB Cir. Nos. A-102 and A-110 on administrative requirements for grant recipients	OMB Cir. Nos. A-102 and A-110 on administrative requirements for grant recipients	None
Cost principles for grant recipients	None	OMB Cir. Nos. A-21, A-87, and A-122 on cost principles for grant recipients	OMB Cir. Nos. A-21, A-87, and A-122 on cost principles for grant recipients	None

Source: GAO.

The LSC 1996 Amendments include other grant management provisions. For example, the LSC 1996 Amendments require the board to select LSC grant recipients through the implementation of a system of competitive awards, including such selection criteria as (1) the demonstration of an understanding of client legal needs and capability of serving such needs; (2) the quality, feasibility, and cost-effectiveness of the proposed plan for delivery of legal assistance; and (3) LSC's past experience with the applicant, including the record of past compliance with LSC requirements. The LSC 1996 Amendments require the board to ensure that no grant recipient uses LSC funds for any litigation activity in providing client legal services unless certain recordkeeping requirements are met. For all cases or matters, the LSC 1996 Amendments require the board to obtain the grant recipient's agreement to maintain timekeeping records. Additionally, the LSC 1996 Amendments require the board, before providing funding to a grant recipient, to ensure that the grant recipient enters into a contractual agreement to be subject to all federal laws relating to the proper use of federal funds (i.e., not using federal funds for fraud, waste, or abuse) and that for such purposes LSC shall be considered a federal agency and its grant funds shall be considered federal funds.³ Finally, LSC has issued regulations on its administration of grants, including provisions establishing cost standards and procedures.⁴

³See 1996 Appropriations Act, §§ 503, 504(a)(8), (a)(10)(A), (a)(19).

⁴See 45 C.F.R. ch. 16.

Requirements for audits of grants provided by federal agencies and U.S. government corporations are found in the Single Audit Act, as amended,⁵ which established uniform audit requirements for state and local governments and nonprofit organizations that receive grants or other forms of federal financial assistance. In addition to uniform audit requirements, the Single Audit Act is intended to “promote sound financial management, including effective internal controls, with respect to Federal awards administered by non-Federal entities” and “promote the efficient and effective use of audit resources.”⁶ The Office of Management and Budget (OMB) has issued implementing regulations on the Single Audit Act in OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (rev. June 27, 2003).

Under the Single Audit Act and implementing regulations, generally grant recipients must annually arrange for an independent auditor to conduct an audit in accordance with GAGAS and prepare a report on the grant recipient’s financial statements and schedule of expenditures, internal controls, and compliance with laws and regulations. The auditor must report whether (1) the financial statements are presented fairly in all material respects in conformity with GAAP and (2) the schedule of expenditures of the grants is presented fairly in all material respects in relation to the financial statements taken as a whole. With respect to internal controls, the auditor must obtain an understanding of each of the grant recipient’s major programs, assess control risk, and perform tests of the controls. The auditor must also determine whether the grant recipient has complied with the provisions of laws, regulations, and contracts or grants related to the grant that have a direct and material effect on each major program. The Single Audit Act requires each grantor federal entity to assess the quality of such audits and monitor the grant recipient’s use of the federal funds received pursuant to the grant. The Single Audit Act also requires any auditor of a grant recipient to provide access to the auditor’s workpapers in response to a request from the grantor federal entity or the Comptroller General as part of either’s activities in furthering their oversight responsibilities.

In addition to providing guidance on audits of grant recipients of federal entities, OMB uses the authority it possesses under a number of statutes to

⁵31 U.S.C. §§ 7501-7507.

⁶Single Audit Act Amendments of 1996, Pub. L. No. 104-156, § 1(b), 110 Stat. 1396 (July 5, 1996) (*reprinted in* 31 U.S.C. § 7501 note).

issue guidance on uniform administrative requirements for federal grants that each federal agency and U.S. government corporation must implement by promulgating entity-specific regulations. OMB has issued two different circulars for grants to different types of entities: OMB Circular No. A-102 applies to grants to state and local governments and OMB Circular No. A-110 applies to grants to institutions of higher education, hospitals, and other nonprofit organizations.⁷ These circulars provide for the use of common forms, such as applications, and common standards, such as grant recipient financial reporting, socioeconomic policies, and grantor monitoring and oversight responsibilities. OMB has also issued guidance providing cost principles for federal entities to use in administering their grants. In three separate circulars, OMB sets out principles to determine the applicability of costs incurred by three groups of entities to federal grants. OMB Circular No. A-87 establishes cost principles for state, local, and tribal governments; whereas OMB Circular Nos. A-21 and A-122 establish such principles, respectively, for institutions of higher education and nonprofit organizations.⁸

Acquisition and Management of Property and Services

Unlike most independent federal agencies and wholly owned government corporations, LSC is not subject to a wide range of federal laws and regulations that govern the acquisition and management of property and services, such as the Federal Acquisition Regulation (FAR) or the Federal Travel Regulation (FTR). (See table 7.) As a D.C. nonprofit corporation, LSC has few limitations on its acquisition, management, disposition, and contract activities in relation to real and personal property and services. Under the D.C. Nonprofit Corporation Act,⁹ it can acquire any interest in real or personal property by purchase, gift, lease, or contract and then “own, hold, improve, use and otherwise deal in and with” such property. LSC can also dispose of any property interest through sale, mortgage,

⁷See OMB Circular No. A-102, *Grants and Cooperative Agreements With State and Local Governments* (rev. Aug. 29, 1997), and OMB Circular No. A-110, *Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations*, which is now codified at 2 C.F.R. pt. 215.

⁸The guidance in these circulars has now been codified at 2 C.F.R. pt. 225 (A-87), pt. 220 (A-21), and pt. 230 (A-122).

⁹D.C. Code § 29-301.05.

Appendix III: Comparison of Other Key LSC Requirements

lease, exchange, transfer, or any other suitable method.¹⁰ LSC also has the power to acquire services through making contracts and incurring liabilities.

Table 7: Key Acquisition and Management of Property and Services Requirements

	LSC	Independent federal agencies	U.S. government corporations	D.C. nonprofit corporations
Property management	None	Public Buildings Act of 1959; Federal Property and Administrative Services Act of 1949; Federal Management Regulation	Wholly owned U.S. government corporations: Public Buildings Act of 1959; Federal Property and Administrative Services Act of 1949; Federal Management Regulation	None
Procurements and acquisition management	None	Federal Property and Administrative Services Act of 1949; Office of Federal Procurement Policy Act; Federal Acquisition Regulation; Competition in Contracting Act of 1984	Wholly owned U.S. government corporations: Federal Property and Administrative Services Act of 1949; Office of Federal Procurement Policy Act; Federal Acquisition Regulation; Competition in Contracting Act of 1984	None
Information technology acquisition management	None	Clinger-Cohen Act of 1996	Wholly owned U.S. government corporations: Clinger-Cohen Act of 1996	None
Travel management	None	5 U.S.C. ch. 57, travel statute; Federal Travel Regulation	Wholly owned U.S. government corporations: 5 U.S.C. ch. 57, travel statute; Federal Travel Regulation	None

Source: GAO.

In procuring property and services, most independent federal agencies and wholly owned U.S. government corporations¹¹ are subject to a number of laws and regulations, including the Public Buildings Act of 1959,¹² the Federal Property and Administrative Services Act of 1949,¹³ the Office of

¹⁰In B-308037, Sept. 12, 2006, GAO concluded that LSC, exercising powers authorized by the D.C. Nonprofit Corporation Act related to real property, had the legal authority to create a wholly owned subsidiary nonprofit corporation to acquire, hold, and manage assets for LSC's use and to lease property from that subsidiary.

¹¹A limited number of mixed-ownership U.S. government corporations, such as the Federal Deposit Insurance Corporation, are subject to the Public Buildings Act of 1959 under its definition for "executive agency." See 40 U.S.C. § 3301(a)(3).

¹²40 U.S.C. ch. 33 (acquisition and management of real property).

¹³40 U.S.C. subtit. I (acquisition of real and personal property and services) and relevant portions of Title 41 of the U.S. Code.

Federal Procurement Policy Act,¹⁴ the Competition in Contracting Act of 1984,¹⁵ the FAR,¹⁶ and the Federal Management Regulation (FMR).¹⁷ These laws and regulations set out authorities, requirements, and standards for most independent federal agencies and U.S. government corporations to manage their acquisition and property systems.

Information technology and travel services are important types of property and services that federal and nonprofit entities need to acquire. Federal agencies and wholly owned U.S. government corporations, but not LSC, are subject to federal governmentwide management laws in these areas. The Clinger-Cohen Act of 1996,¹⁸ governs information technology acquisitions by federal agencies and wholly owned U.S. government corporations, requiring, among other things, the design and implementation of a process for maximizing the value, and assessing and managing the risks of the entity's information technology acquisitions, as well as the creation of a chief information officer position to help manage this process.¹⁹ Federal agencies and wholly owned U.S. government corporations, but not LSC, are also subject to statutory requirements for travel by federal civilian employees, as well as the implementing the FTR, promulgated by the General Services Administration,²⁰ which are intended to regulate travel "in a manner that balances the need to assure that official travel is conducted in a responsible manner with the need to minimize administrative costs."²¹ For example, the FTR provides rules on

¹⁴41 U.S.C. ch. 7 (acquisition policies).

¹⁵Pub. L. No. 98-369, div. B, tit. VII, 98 Stat. 1175 (July 18, 1984) (standards and requirements for competitively awarding contracts), which has been codified, in relevant part, in 10 U.S.C. § 2304 and 41 U.S.C. § 253.

¹⁶FAR, Title 48 of the U.S. Code of Federal Regulations.

¹⁷FMR, 41 C.F.R. ch. 102.

¹⁸40 U.S.C. subtit. III (requirements and standards for acquiring and managing information technology).

¹⁹40 U.S.C. §§ 11312, 11315.

²⁰See federal civilian travel statutes at 5 U.S.C. ch. 57; FTR, 41 C.F.R. ch. 300-304.

²¹FTR, 41 C.F.R. § 300-1.2(a).

when government employees may use first-class or business-class airline accommodations.²²

Human Resources Management

Under the D.C. Nonprofit Corporation Act, the LSC board possesses broad powers in relation to its officers, employees, and other agents with only limited restrictions imposed on this power by the LSC Act and other D.C. statutes.²³ (See table 8.) Unlike federal agencies, LSC is not subject to the laws in the U.S. Code relating to the executive branch workforce.²⁴ For example, like directors of other private nonprofit, tax-exempt corporations, the LSC directors have the power to determine the rates of compensation of LSC's officers and employees so long as the compensation is not so high that it might constitute prohibited personal inurement.²⁵ In one of its few human resources restrictions, however, the LSC Act specifically makes LSC subject to certain laws governing pay and benefits for civilian employees of federal agencies and wholly owned U.S. government corporations. The LSC Act does so by imposing a ceiling on compensation for any LSC officer or employee who is linked to a federal pay schedule under federal law: level V of the Executive Schedule, which in calendar year 2006 was \$133,900.²⁶ The LSC Act also treats LSC as a federal entity for purposes of personnel participation in specified federal employee benefits programs to which LSC is required to make contributions at the same rates applicable to federal employers.

²²FTR, 41 C.F.R. §§ 301-10.123, - 10.124.

²³Title 31 of the D.C. Code includes separate chapters that regulate wages, occupational health and safety, parental leave, and family and medical leave, among other matters.

²⁴Title 5 of the U.S. Code includes a comprehensive statutory framework for the relationship between federal agencies and their officers and employees.

²⁵Personal inurement would constitute an excess benefit transaction subject to special excise taxes. See 26 U.S.C. § 4958, and implementing regulations at 26 C.F.R. § 53.4958-1.

²⁶See Office of Personnel and Management, 2006 Salary Tables and Related Information, available at <http://www.opm.gov/oca/06tables/index.asp> (last visited Apr. 19, 2007). For federal employees paid under the Executive Schedule, there is no eligibility for a locality pay adjustment. See 42 U.S.C. § 5304(h).

Appendix III: Comparison of Other Key LSC Requirements

Table 8: Key Human Resources Management Structures

	LSC	Independent federal agencies	U.S. government corporations	D.C. nonprofit corporations
Employment	D.C. Code, Title 32; LSC Act	Title 5 of the U.S. Code	Title 5 of the U.S. Code (most provisions apply to wholly owned U.S. government corporations, but only some provisions apply to mixed-ownership U.S. government corporations)	D.C. Code, Title 32
Whistleblower Protection	Inspector General Act (IG Act) for disclosures made to the IG. If disclosure results in termination: Wrongful discharge cause of action under D.C. law's public policy exception to at-will employment doctrine	Whistleblower Protection Act	Whistleblower Protection Act (certain provisions)	If disclosure results in termination: Wrongful discharge cause of action under D.C. law's public policy exception to at-will employment doctrine; CPB also subject to IG Act for disclosures made to the IG

Source: GAO.

Unlike the employees of LSC and other Washington, D.C., nonprofit corporations, employees of federal agencies and, to a limited extent, U.S. government corporations, enjoy certain protections under the Whistleblower Protection Act²⁷ when they engage in “whistleblowing,” which involves reporting evidence of illegal or improper federal employer activities to the relevant authorities. For example, federal agency and U.S. government corporation supervisors may not take disciplinary action against an employee for disclosing information that the employee reasonably believes evidences gross mismanagement, a gross waste of funds, an abuse of authority, or a substantial and specific danger to public health or safety.²⁸ There is no equivalent statutory provision for employees

²⁷5 U.S.C. § 2302.

²⁸5 U.S.C. § 2302(b)(8)(A). This provision is similar to a recently enacted whistleblower protection statute applicable to public companies under the Sarbanes-Oxley Act. Under 18 U.S.C. § 1514A, public companies and their officers, employees, and agents are prohibited from taking certain actions against a public company’s employee if that employee discloses information to designated entities about violations of certain criminal laws or securities rules or regulations. The District of Columbia also has enacted whistleblower protections for its employees and employees of its contractors. *See* D.C. Code §§ 1-615.51—1-615.59. These protections, however, do not apply to employees of D.C. nonprofit corporations if their employer is not a contractor with the D.C. government.

of Washington, D.C., nonprofit corporations, such as LSC or CPB. Under Washington, D.C., law, however, if a D.C. nonprofit corporation terminates an employee because he or she disclosed information of employer misconduct, such as illegal activities, then the terminated employee can sue the corporation for wrongful discharge under D.C. law's public policy exception to the at-will employment doctrine that at-will employees can be terminated at any time for any reason.²⁹ Furthermore, LSC employees, like those of CPB and federal entities subject to the IG Act, enjoy additional protections not available to employees of typical D.C. nonprofit corporations. Under the IG Act the IG must not, without the employee's consent, disclose the identity of an employee who informs the IG about the possible existence of an activity at LSC constituting a violation of law, rules, or regulations, or mismanagement, gross waste of funds, abuse of authority, or a substantial and specific danger to the public health and safety. The IG Act also prohibits the LSC employee's manager from retaliating, or threatening to retaliate, against the employee for this communication with the IG, unless the employee provided the information to the IG with knowledge that it was false or with willful disregard for its truth or falsity.³⁰

Recordkeeping and Public Access to Information

Large organizations such as LSC generate print and electronic records and conduct executive meetings as part of their regular course of business. LSC's statutory requirements for access to information are similar to those of federal entities, but its recordkeeping requirements are not as rigorous. However, LSC's requirements for access to information and recordkeeping are stronger than those for other Washington, D.C., nonprofit corporations. (See table 9.)

²⁹See, e.g., *Liberatore v. Melville Corp.*, 168 F.3d 1326 (D.C. Cir. 1999), in which the appellate court found that the employee had stated a cause of action under D.C. law for wrongful discharge related to his employer's firing him in retaliation for his threat to disclose to the Food and Drug Administration the unlawful condition in which his employer was storing pharmaceutical drugs.

³⁰IG Act, 5 U.S.C. appx. § 7.

Appendix III: Comparison of Other Key LSC Requirements

Table 9: Key Recordkeeping and Public Access to Information Structures

	LSC	Independent federal agencies	U.S. government corporations	D.C. nonprofit corporations
Recordkeeping	LSC Act: 3-year retention for records supporting financial audit	Federal Records Management laws and regulations	Wholly owned U.S. government corporations: Federal Records Management laws and regulations	D.C. Code § 29.301-26 (keeping of books, accounts, and minutes of board meetings); CPB required; CPB subject to requirement of 3-year retention for records supporting financial audit
Public information	Freedom of Information Act (FOIA)	FOIA	FOIA	None; CPB required to keep certain records in its offices available for public inspection and copying
Open meetings	Government in the Sunshine Act	Government in the Sunshine Act (if headed by a multiperson body)	Government in the Sunshine Act	None; CPB subject to open meetings requirement resembling Sunshine Act's
Notice-and-comment rule making	LSC Act: Administrative Procedures Act -like notice-and-comment rule making	Administrative Procedures Act (APA)	APA	None

Source: GAO.

The LSC Act imposes some limited recordkeeping requirements on LSC, such as a 3-year retention period for records that support its annual financial audit and a requirement to keep copies of reports on grantees. CPB is subject to a similar 3-year retention period for records supporting its annual financial audit,³¹ but other Washington, D.C., nonprofit corporations are subject to only minimal recordkeeping requirements, including keeping correct and complete books and records of account and minutes of board proceedings, which do not have to meet any particular standard.³² Under the Federal Records Management laws,³³ however, the

³¹47 U.S.C. § 396(I)(4)(A).

³²D.C. Code § 29.301-26.

³³Federal Records Management laws are codified in Title 44 of the U.S. Code in chapter 21 (National Archives and Records Administration), chapter 25 (National Historical Publications and Records Commission), chapter 29 (Records Management by the Archivist of the United States and by the Administrator of General Services), chapter 31 (Records Management by Federal Agencies), and chapter 33 (Disposal of Records). Of particular interest, the National Archives and Records Administration has issued implementing regulations in Title 36 of the U.S. Code of Federal Regulations.

heads of independent federal agencies and wholly owned U.S. government corporations have much broader recordkeeping duties: the creation of records to document all “essential transactions” and retention of these records for specified time periods depending on the type of transaction documented.

For any records that LSC, federal agencies, and U.S. government corporations retain, they must provide the public with access to these records as required by the Freedom of Information Act (FOIA). FOIA requires that federal entities make their records available for public inspection and copying unless one of the listed FOIA exemptions apply, such as the exemptions for records pertaining to medical files, internal personnel practices, or trade secrets.³⁴ This is one of the handful of provisions in the LSC Act in which the LSC Act provides that LSC shall be treated as a federal agency. There is no comparable public right to access corporate records under the D.C. Nonprofit Corporation Act. While CPB is not subject to FOIA, it does include a records access provision requiring CPB to maintain certain records at its office and to make them available for public inspection and copying.³⁵

LSC is also subject to the Government in Sunshine Act (Sunshine Act),³⁶ which means that all board meetings, including meetings of any executive committee of the board, must be open to public observation. In following the Sunshine Act, the LSC board must follow the procedural requirements for providing adequate notice of meetings, as well as for closing all or a portion of a meeting based on discussion of exempted subject matter, such as personnel matters or pending litigation. In this respect, LSC is no different from other entities subject to the Sunshine Act, which are U.S. government corporations and federal agencies headed by a collegial body, and very different from most D.C. nonprofit corporations that are subject to no similar requirement. Although not subject to the Sunshine Act, the CPB board has an open meetings requirement that resembles Sunshine Act requirements.³⁷

³⁴FOIA, Pub. L. No. 89-487, 80 Stat. 250 (July 4, 1976), *codified, as amended, at* 5 U.S.C. § 552.

³⁵47 U.S.C. § 396(l)(4)(A).

³⁶Government in the Sunshine Act, Pub. L. No. 94-409, 90 Stat. 1241 (Sept. 13, 1976), *codified, as amended, at* 5 U.S.C. § 552b.

³⁷*See* 47 U.S.C. §§ 396(g)(4), (k)(4).

While LSC is not subject to the “notice-and-comment rule making” under the Administrative Procedures Act of 1946 (APA),³⁸ LSC must provide interested parties with “notice and a reasonable opportunity for comment” on all proposed rules, regulations, and guidelines, and must publish these requirements in the *Federal Register* at least 30 days prior to their effective date. Federal agencies and U.S. government corporations are subject to similar requirements in APA, whereas D.C. nonprofit corporations have no similar rulemaking requirement for public participation.

³⁸APA, *codified, as amended*, at 5 U.S.C. § 553.

Appendix IV: Comparison of Key LSC Governance and Accountability Requirements

	LSC	Independent federal agencies	U.S. government corporations	D.C. nonprofit corporations
Governance structures	Inspector general: IG Act	Inspector general: IG Act	Inspector general: IG Act	Inspector general: Generally not applicable, but IG Act applies to CPB
	Committees authorized: D.C. Code § 29-301.22	Committees authorized: Committees neither prohibited nor required	Committees authorized: Committees neither prohibited nor required	Committees authorized: D.C. Code § 29-301.22
	Governing body: Board of directors: presidential appointment with Senate approval, for cause removal by vote of 7 directors	Governing body: Independent federal agencies headed by a multiperson body: commission or board of directors: mostly presidential appointment with Senate approval, often silent on removal	Governing body: Board of directors: mostly presidential appointment with Senate approval, often silent on removal	Governing body: Board of directors: D.C. Code §§ 29-301.18, 29-301.19, CPB Act, presidential appointment with senate approval, silent on removal
Funds control and budgeting	Limitation on amount of funds available for use: None	Limitation on amount of funds available for use: Antideficiency Act	Limitation on amount of funds available for use: wholly owned U.S. government corporations: Antideficiency Act	Limitation on amount of funds available for use: None
	Funds used only for authorized purposes: None	Funds used only for authorized purposes: Purpose Statute (31 U.S.C. § 1301(a))	Funds used only for authorized purposes: Purpose Statute (31 U.S.C. § 1301(a))	Funds used only for authorized purposes: None
	Annual budget: LSC Act (request made directly to Congress: no content or form requirements; OMB comment and review allowed)	Annual budget: 31 U.S.C. §§ 1105, 1108 (agency budget submitted to the President for inclusion in the Budget of the U.S. Government)	Annual budget: Wholly owned U.S. government corporations: 31 U.S.C. § 9103 (Government Corporation Control Act)	Annual budget: Generally not applicable; CPB prepares an annual budget
	Liability of accountable officers for improper or illegal use of funds: None	Liability of accountable officers for improper or illegal payment of funds: 31 U.S.C. §§ 3528, 3325	Liability of accountable officers for improper or illegal payment of funds: some wholly owned U.S. government corporations: 31 U.S.C. §§ 3528, 3325	Liability of accountable officers for improper or illegal use of funds: None
Performance and financial reporting	Financial statements and reports: Annual report on corporation accounts: LSC Act (report of annual audit of LSC's accounts)	Financial statements and reports: Annual audited financial statements: 31 U.S.C. § 3515 (Chief Financial Officers Act of 1990, Government Management Reform Act of 1994, Accountability of Tax Dollars Act of 2002)	Financial statements and reports: Annual audited financial statements: 31 U.S.C. §§ 9105, 9106 (Government Corporation Control Act)	Financial statements and reports: Financial reports: D.C. Code § 29-301.26 (keep correct and complete books and records of account); CPB required to prepare annual audit report on CPB accounts

**Appendix IV: Comparison of Key LSC
Governance and Accountability Requirements**

	LSC	Independent federal agencies	U.S. government corporations	D.C. nonprofit corporations
	Accounting standards applied: No GAAP specified; LSC now using GASB GAAP	Accounting standards applied: FASAB GAAP	Accounting standards applied: Some FASAB GAAP; some FASB GAAP	Accounting standards applied: FASB GAAP
	None	Strategic plans: 5 U.S.C. § 306; Performance plans and reports: 31 U.S.C. §§ 1115-1116 (Government Performance and Results Act of 1993)	Strategic plans: 5 U.S.C. § 306; Performance plans and reports: 31 U.S.C. §§ 1115-1116 (Government Performance and Results Act of 1993)	Performance reports: D.C. Code § 29-301.26 (keep minutes of board proceedings); CPB required to submit annual report to President and Congress
Accounting and internal control systems	System of internal control and Assurances: None	System of internal control and Assurances: 31 U.S.C. § 3512(c), (d) (Federal Managers' Financial Integrity Act of 1982)	System of internal control and Assurances: 31 U.S.C. § 9106 (Government Corporation Control Act)	System of internal control and Assurances: None
	Information system security: None	Information system security: Federal Information Security Management Act of 2002	Information system security: Federal Information Security Management Act of 2002	Information system security: None
Grants management	Audits of grant recipients: 1996 LSC Amendments	Audits of grant recipients: Single Audit Act; OMB Circular No. A-133 on audits of grant recipients	Audits of grant recipients: Single Audit Act; OMB Circular No. A-133 on audits of grant recipients	Audits of grant recipients: None
	Grant management requirements: 1996 LSC Amendments	Grant management requirements: OMB Circular Nos. A-102 and A-110 on administrative requirements for grant recipients	Grant management requirements: OMB Circular Nos. A-102 and A-110 on administrative requirements for grant recipients	Grant management requirements: None
	Cost principles for grant recipients: None	Cost principles for grant recipients: OMB Circular Nos. A-21, A-87, and A-122 on cost principles for grant recipients	Cost principles for grant recipients: OMB Circular Nos. A-21, A-87, and A-122 on cost principles for grant recipients	Cost principles for grant recipients: None
Acquisition and management of property and services	Property management: None	Property management: Public Buildings Act of 1959; Federal Property and Administrative Services Act of 1949; Federal Management Regulation	Property management: Wholly owned U.S. government corporations: Public Buildings Act of 1959; Federal Property and Administrative Services Act of 1949; Federal Management Regulation	Property management: None

**Appendix IV: Comparison of Key LSC
Governance and Accountability Requirements**

	LSC	Independent federal agencies	U.S. government corporations	D.C. nonprofit corporations
	Procurements and acquisition management: None	Procurements and acquisition management: Federal Property and Administrative Services Act of 1949; Office of Federal Procurement Policy Act; Federal Acquisition Regulation; Competition in Contracting Act of 1984	Procurements and acquisition management: Wholly owned U.S. government corporations: Federal Property and Administrative Services Act of 1949; Office of Federal Procurement Policy Act; Federal Acquisition Regulation; Competition in Contracting Act of 1984	Procurements and acquisition management: None
	Information technology acquisition management: None	Information technology acquisition management: Clinger-Cohen Act of 1996	Information technology acquisition management: Wholly owned U.S. government corporations: Clinger-Cohen Act of 1996	Information technology acquisition management: None
	Travel management: None	Travel management: 5 U.S.C. ch. 57, travel statute; Federal Travel Regulation	Travel management: Wholly owned U.S. government corporations: 5 U.S.C. ch. 57, travel statute; Federal Travel Regulation	Travel management: None
Human resources management	Employment: D.C. Code, Title 32; LSC Act	Employment: Title 5 of the U.S. Code	Employment: Title 5 of the U.S. Code (Most provisions apply to wholly owned U.S. government corporations, but only some provisions apply to mixed-ownership government corporations)	Employment: D.C. Code, Title 32
	Whistleblower protection: IG Act for disclosures made to the IG. If disclosure results in termination: Wrongful discharge cause of action under D.C. law's public policy exception to at-will employment doctrine	Whistleblower protection: Whistleblower Protection Act	Whistleblower protection: Whistleblower Protection Act (certain provisions)	Whistleblower protection: If disclosure results in termination: Wrongful discharge cause of action under D.C. law's public policy exception to at-will employment doctrine; CPB, also subject to IG Act for disclosures made to the IG

**Appendix IV: Comparison of Key LSC
Governance and Accountability Requirements**

	LSC	Independent federal agencies	U.S. government corporations	D.C. nonprofit corporations
Recordkeeping and access to information	Recordkeeping: LSC Act: 3-year retention for records supporting financial audit	Recordkeeping: Federal Records Management laws and regulations	Recordkeeping: Wholly owned U.S. government corporation Federal Records Management laws and regulations	Recordkeeping: D.C. Code § 29.301-26 (keeping of books, accounts, and minutes of board meetings); CPB required; CPB subject to requirement of 3-year retention for records supporting financial audit
	Public information: Freedom of Information Act	Public information: Freedom of Information Act	Public information: Freedom of Information Act	Public information: None; CPB required to keep certain records in its offices available for public inspection and copying
	Open meetings: Government in the Sunshine Act	Open meetings: Government in the Sunshine Act (if headed by a multiperson body)	Open meetings: Government in the Sunshine Act	Open meetings: None; CPB subject to open meetings requirement resembling Sunshine Act's
	Notice-and-comment rule making: LSC Act: APA-like notice-and-comment rulemaking	Notice-and-comment rule making: APA	Notice-and-comment rule making: APA	Notice-and-comment rule making: None

Source: GAO.

Appendix V: Comments from the Legal Services Corporation Board of Directors



Legal Services Corporation
America's Partner for Equal Justice

August 2, 2007

Ms. Jeannette M. Franzel
Director, Financial Management and Assurance
U.S. Government Accountability Office
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Helaine M. Barnett

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Chairman

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Jonann C. Chiles
Little Rock, AR

Thomas A. Fuentes
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Herbert S. Garten
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David Hall
Boston, MA

Michael D. McKay
Seattle, WA

Thomas R. Meites
Chicago, IL

Bernice Phillips
Buffalo, NY

Sarah M. Singleton
Santa Fe, NM

Dear Ms. Franzel:

Thank you for giving the Legal Services Corporation Board the opportunity to respond to the GAO Draft Report entitled *Legal Services Corporation Governance and Accountability Practices Need To Be Modernized and Strengthened*, GAO-07-993 (GAO Draft). At its meetings on July 27 and 28 in Nashville, the Board took the opportunity to consider the GAO Draft and its recommendations, and we offer the following comments in response. We address only the GAO Draft's recommendations to the Board and its recommendations to Congress. We understand that LSC Management will be offering its own comments.

The Board was gratified that GAO identified no violations, by the Board or the Legal Services Corporation, of applicable statutory governance requirements. We understand that the practices that GAO recommends are ones that GAO has identified as having become standard operating procedures for many non-profit organizations or government entities subsequent to LSC's creation. We appreciate that good governance practices and enhanced accountability mechanisms can add value. Within the constraints imposed by the limited resources Congress provides to administer LSC, the Board will make every effort to comply with the spirit of GAO's recommendations. Specifically, with respect to your recommendations to us, the Board will:

- attempt to insure that new members receive orientation to familiarize them both with LSC's programmatic roles and on governance and accountability;
- continue to receive updates from Management on issues having to do with LSC's operating environment, governance, and accountability;
- decide whether to create a separate Audit Committee or assign the function to the Finance Committee;

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- determine how to assign responsibility within the Board for compensation issues;
- formalize the functions of Board committees by adopting charters for them;
- consider adopting a formal means by which the Board can evaluate its collective performance and the performance of individual members;
- encourage the IG, who is charged with contracting with LSC's auditor, to require that the auditor report within 45 days of the end of the fiscal year; and
- work with Management as appropriate on any risk management program, internal controls, and financial reporting.

With regard to the GAO Draft's recommendations to Congress to make LSC either a federal agency or a U.S. government corporation, we believe that the current structure has historically worked well to achieve the mission that Congress gave LSC. Fundamentally restructuring LSC as proposed by the GAO Report is certain to be costly and may not be totally productive. It should not be undertaken without thorough Congressional study and consideration of the legislative history. The Board is convinced that it is far from certain that restructuring the organization will produce gains in LSC's ability to achieve its basic mission of providing civil legal services to low-income people. Many of the governance recommendations, if appropriate, can be accomplished by amending the by-laws of the corporation (referred to as charters by the GAO report) or by resolution of the board of directors. Therefore, the Board cannot agree that Congress should act on your recommendations.

Again, we thank you for sharing the GAO Draft with us and giving us the opportunity to comment on its recommendations. We reiterate our commitment that, within the resources available to us, LSC should adopt the best possible governance practices and accountability mechanisms.

Sincerely,



Frank B. Strickland
Chairman

Appendix VI: Comments from the Legal Services Corporation



Legal Services Corporation
America's Partner for Equal Justice

July 31, 2007

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Bernice Phillips
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Sarah M. Singleton
Santa Fe, NM

Dear Ms. Franzel:

Thank you for the opportunity to provide written comments on the Government Accountability Office (GAO) draft report entitled *Legal Services Corporation – Governance and Accountability Practices Need To Be Modernized and Strengthened*. This is Management's response to your draft report. The Board of Directors is responding separately.

We are pleased with your findings that LSC "has stronger federal accountability requirements than many nonprofit corporations" and that LSC Board members "demonstrated active involvement through their strong board meeting attendance and participation in LSC oversight." We intend to build on this strong base of accountability and oversight as we respond to the recommendations for executive action which you have made. We fully accept three of your recommendations and we are committed to further action in the spirit of the fourth recommendation.

- Regarding the appropriate financial reporting standard for LSC, we are reviewing the Government Accounting Standards Board standards, and we expect to complete our evaluation by the end of October 2007.
- Regarding a Continuity of Operations Plan program, LSC has adopted elements of a program, as noted in your draft report, and we expect to complete our comprehensive program during 2008.
- Regarding a code of conduct, we have established a staff task force to develop proposals for an LSC compliance program, which will include a comprehensive code of conduct. Our goal is to have recommendations to the Board of Directors by the January 2008 Board meeting.
- Regarding a risk management program, we are committed to improving the risk management program at LSC. We note that LSC has managed its risks well over the past 33 years. We will review and implement those additional program elements that are desirable and appropriate for an organization of our size.

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We recommend that several clarifications be made to your draft report narrative to insure its overall accuracy. In discussing the accountability of LSC for the management of its federal appropriations, the draft report does not address the existence of congressional oversight. LSC has both authorizing and appropriations committees in the House and the Senate, and LSC is subject to regular oversight from these committees. LSC has been the subject of appropriations and oversight hearings five times in the past three years. LSC staff meet regularly with both Members and congressional staff to discuss ongoing operations.

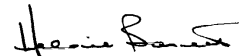
In discussing LSC's whistleblower protections, the draft report does not acknowledge that LSC has a whistleblower protection statement in its Employee Handbook. This protection for those who complain to the Office of Inspector General (OIG) has been in place at LSC for almost 20 years.

The draft report references potential conflicts of interest with respect to LSC's Acting Special Counsels. All of the relevant information relating to the Acting Special Counsels was provided to the OIG. The OIG made no findings of any conflict of interest with respect to the Acting Special Counsels, and no report of any potential conflicts of interest exists. LSC has been and remains diligent in its ethical obligation to avoid any conflicts of interest. Since the draft report itself makes no finding by GAO of potential conflicts of interest, the placement of this reference in the "What GAO Found" section (see Highlights page) is particularly troublesome.

Finally, while we recognize that your recommendations of matters for congressional consideration are not made to LSC, we feel compelled to observe that LSC's existing statutory framework is appropriate and has served very well the purposes which Congress intended, as described in the appendices to the draft report which explain the rationale for establishing LSC as a non-profit corporation. Should there be a desire to apply some additional management requirements to LSC, that can be accomplished without modifying the nonprofit corporation framework which Congress enacted. To change the framework of LSC to that of a government corporation or federal agency would subject the mission of providing civil legal assistance to poor people to the kind of political pressure and operational controls which Congress wisely sought to avoid in 1974.

Thank you for the opportunity to comment upon the draft report. This has been a helpful and constructive process for us. We welcome your recommendations for executive action.

Sincerely,



Helaine M. Barnett
President

Appendix VII: GAO Contact and Staff Acknowledgments

GAO Contact

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Acknowledgments

In addition to the person named above, F. Abe Dymond; Lauren S. Fassler; Joel I. Grossman; Maxine L. Hattery; Stephen R. Lawrence; Kimberley A. McGatlin; and Matthew P. Zaun made key contributions to this report.

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