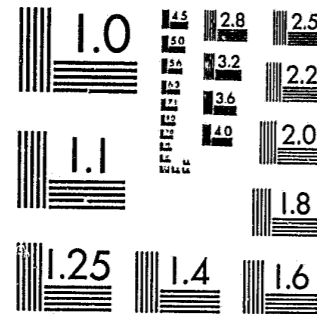


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11/8/83

LEGAL SERVICES CORPORATION—1981

OVERSIGHT HEARING
BEFORE THE
SUBCOMMITTEE ON COURTS, CIVIL LIBERTIES,
AND THE ADMINISTRATION OF JUSTICE
OF THE
COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES
NINETY-SEVENTH CONGRESS
FIRST SESSION
ON
LEGAL SERVICES CORPORATION—1981
FEBRUARY 26, 1981
Serial No. 2



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LEGAL SERVICES CORPORATION—1981

THURSDAY, FEBRUARY 26, 1981

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COURTS, CIVIL LIBERTIES,
AND THE ADMINISTRATION OF JUSTICE,
OF THE COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The subcommittee met at 10:17 a.m., in room 2237, Rayburn House Office Building, Hon. Robert W. Kastenmeier (chairman of the subcommittee) presiding.

Present: Representatives Kastenmeier, Frank, Railsback, Sawyer, and Butler.

Staff present: Gail Higgins Fogarty, counsel; Thomas E. Mooney and Joseph V. Wolf, associate counsel; and Audrey Marcus, clerk.

Mr. KASTENMEIER. We will come to order.

Today we commence our first day of oversight hearings concerning the organizations for which this subcommittee has responsibility.

It is particularly fitting that we should start with the Legal Services Corporation, which is a part of our civil justice system. We have watched this Corporation develop and grow since the date on which its first board of directors was installed, July 14, 1975.

We have had a cooperative relationship with the Corporation, and generally the cooperation has been very responsive to the issues which we have raised at various meetings and hearings.

The Legal Services Corporation was created as a private, non-profit Corporation incorporated in the District of Columbia by Congress, which was concerned about the need for effective representation of those persons unable to afford civil legal aid.

The creation of an entity entirely independent of the executive branch or, for that matter, any governmental entity, was considered essential to maintaining the professional integrity of the delivery of legal services.

I believe that the independence of the Corporation must be preserved. The Corporation was first funded in 1975, and received approximately \$90 million in funds.

It was only able to deliver minimal services to a small portion of the poor, approximately 1.3 million persons.

Today, the Corporation is providing minimum access, that is, two attorneys per 10,000 persons, to approximately 30 million poor persons.

The funding level for fiscal year 1981 is \$321.3 million. The House Committee on the Judiciary, I should note, did not process the original bill which created the Corporation. We assumed jurisdiction from the House Committee on Education and Labor late in 1974.

But in 1977, we did process amendments to the Legal Services Corporation Act. At that time, the Congress extended the authorization for appropriations for 3 additional years, 1977 to 1980.

We made several other changes in the law. Last year, the committee had approved a bill, HR 6386, extending the authorization for appropriation for 3 more years, but due to a number of reasons, the bill was not ultimately considered by the House in its final days.

Therefore, the appropriation has been funded for this fiscal year through a continuing appropriation—Public Law 96-536.

This subcommittee will hold several days of hearings on legislation to extend the authorization for appropriations for the Corporation.

Hearings will commence on March 17. We expect several witnesses to testify, including those critical of the Corporation.

At this time, I take a great deal of personal pleasure in welcoming Mr. Dan Bradley. Mr. Bradley, the Corporation's second president, has served in that capacity since 1979.

He has been very responsive to problems raised by Members of the Congress and other problems raised in connection with the Corporation, and has certainly been responsive to this committee. We welcome you.

TESTIMONY OF DAN BRADLEY, PRESIDENT, LEGAL SERVICES CORPORATION

Mr. BRADLEY. Thank you, Mr. Chairman. I welcome the opportunity to appear back before this subcommittee and review with you the activities of the Legal Services Corporation.

Mr. Chairman, and members of the subcommittee, on behalf of the board of directors and the staff of the Legal Services Corporation, I am grateful for the opportunity to be here today. I would like to ask that my prepared statement and attachments be part of the record. [See app. 1(A)-(C).]

The Corporation has been a very unique and a remarkably successful experiment in the administration of public funds. The statutory approach that the Congress developed in 1974 has not only protected the political independence of the Legal Services Corporation, but has made it possible for us to have a very simple administrative structure, that has avoided the bureaucracy and redtape that plague many federally funded programs. As you know, the Corporation is a private, nonprofit organization, established by Congress in 1974 to insure that poor people are provided equal access to justice.

We are independent of the executive branch of Government. We are governed by an 11-member board of directors appointed by the President, with the advice and consent of the Senate.

The Corporation is subject to an annual financial audit conducted by a nationally certified public accounting firm, Price Waterhouse & Co.

For the fifth year in a row, we recently received a clean bill of health and an unqualified and successful audit from that company. It is with very much pride I will make available to this committee again a copy of the Price Waterhouse report which we recently received. [See app. 1(D)(1).]

I think that on reviewing that report, you will find that the Corporation is financially sound, and administratively efficient, and we are very programmatically effective.

Congress can be assured that we have met the simple goal given to us in 1974, to insure that poor people everywhere unable to afford private attorneys may, nevertheless, gain access to our system of justice when they have a civil-legal problem. It is with that goal in mind that the Corporation has developed its plans since 1975. We have been extremely successful in implementing those plans in a manner that recognizes and respects the needs of our client community.

As I think everyone on this subcommittee knows, our first objective was the minimum access plan. This plan was developed and refined in close consultation with this subcommittee, and also with our Appropriations Subcommittees in the House and the Senate.

It was a plan designed to insure that low-income persons in all parts of this country have available a minimum level of civil legal assistance, and minimum access was very conservatively defined as the equivalent resources of 2 attorneys for every 10,000 poor persons.

I think most of us will recall that in 1975, legal services was unavailable in most parts of the country. A few months ago, I submitted to each of you this map of the United States of America. At the top of it, it says "Poor Persons With Minimum Access in 1975." [See app. 1(B).] I think that it is very graphically important for you to look at the map. That tells you—

Mr. SAWYER. Mine says 1976. Is that the same one?

Mr. BRADLEY. We prepared it for the fiscal year ending 1976. The Corporation came into being in 1975. It is the same chart. That's the picture of Federal funding of legal services at the time that the Legal Services Corporation came into existence. The Corporation took over the support of legal services programs that previously had been funded by OEO, which is now called CSA. That's the way we looked basically in 1975 and 1976.

In vast areas of the South, the Southwest, and the Midwest, low-income persons had no opportunity to see an attorney when they had a civil legal problem.

While there were more than 30 million persons found to be eligible for legal services in 1975, less than 1.3 million of those persons were living in areas where we had a minimum access level of civil legal services.

In 1975, the newly established Corporation set out to correct that situation, as you see it on that map before you now. Our Board developed a minimum access plan, cognizant both of the unmet legal needs of the poor, and also cognizant of the limited funds available.

We presented the plan to Congress and sought funding to implement it in a gradual and responsible manner. In 5 years, this plan has been completed.

I am proud to show you another map—not reprinted. This is the map of the United States today. There are 3,106 counties in America. As of today, we have minimum legal services in all counties. This also includes the Virgin Islands, Puerto Rico, Micronesia, Trust Territories of the Pacific.

The goal of equal access to justice has been the cornerstone of everything the Corporation has done in the last 4 or 5 years. This is a program for and by clients. Our current activities and all of our future plans, I hope make that point perfectly clear.

The Corporation has constantly sought to maximize high quality civil-legal assistance, and at the same time, we have attempted to minimize our bureaucracy and our overhead.

Our funding allocations perhaps best display the strength of both our expenses and our deeds. Mr. Chairman, I have brought three charts with me today which show our funding allocations. They are attached to the written testimony which has been provided to each of you.

Chart 1, which is on your left, indicates the allocation of the Federal funds that we received in fiscal year 1981. Over 93 percent of the funds appropriated by Congress are awarded to local communities for the direct provision of legal services to the poor.

These funds go directly to local legal services programs operating in the territories and jurisdictions that I made reference to. Chart 1 also indicates that the Corporation has made every effort to keep the cost of our administration and bureaucracy to an absolute minimum.

As you see, the smallest slice of that chart, less than 1.6 percent of the moneys appropriated by Congress, is allocated for management and administration of the Corporation.

The Corporation, even though we spend, I think, a relatively small amount of money, I believe that we are well managed. We currently have 210 positions in our Washington office, with another 97 positions located in our 9 regional offices throughout the country.

The management administration responsibilities are critical to the effective operation of this program.

We have other responsibilities also directed to maximizing the delivery of high-quality legal services. If you will note, our regional offices are responsible for the direct monitoring of all local programs on a regional basis.

We have a substantial training program for all lawyers, paralegals, secretaries, support staffs, and others who work in our local programs. Research and experiment are practical efforts to learn more about the needs of our clients and more efficient and productive methods of meeting those needs.

For example, Congress directed that we conduct a major study on the access problems and the special legal problems of special groups of low-income individuals. That report has been completed and made available to this subcommittee.

This subcommittee is also familiar with the delivery system study, the DSS study, which examined alternative ways to deliver and provide legal services.

We are currently engaged in an effort to better define the standards of legal practice for our attorneys that would be particularly useful, and we believe will be a major contribution to the legal profession as a whole.

We have also undertaken a major effort to apply computer technology to legal services management and delivery, which we hope

will increase our program efficiency and productivity, and maximize our resources.

Last year, GAO issued a recommendation, a strong recommendation to the Corporation, suggesting that we apply and use improved technological resources in the delivery of legal services.

All of our efforts are designed to insure that the services provided to the poor are of the highest possible quality.

The Corporation is one small part of the overall program, however, and it is critically important for all of us to understand the role of our local legal services programs. The operation currently funds 323 independent, locally controlled programs providing legal services in local communities.

These programs are operating at 1,450 neighborhood offices throughout the geographical area as shown to you on the map.

Working in these programs are over 6,200 lawyers, 2,800 paralegals, and approximately 7,000 or 8,000 support persons.

Most of these persons are earning salaries that are much, much lower than they could earn in the private sector, or salaries that are much lower than what are paid in other comparable public services jobs.

Mr. KASTENMEIER. Excuse me. May I interrupt? I yield to the gentleman.

Mr. RAILSBACK. I'm going to have to leave. I thought maybe I could ask my question very quickly.

I wonder if you could profile for us the typical legal services lawyer, where they come from, how long they stay, and then where they go.

Mr. BRADLEY. Yes; I will try to do that, Mr. Railsback. I would like to submit for the record a fact book that goes into much greater detail that will answer your question much more fully than in the time that you would probably like for me to take. [See app. 1(C).]

But the typical attorney who joins legal services does so shortly after graduating from law school. That attorney usually is assigned to work in a neighborhood law office. They do basically client-intake work. They handle a huge volume of cases.

The salary for that person varies, depending upon the salary comparability scales established by the board in that local community. The average—

Mr. RAILSBACK. Do we have that in our file?

Mr. BRADLEY. Yes, sir. All of those statistics are in that profile which I have provided.

Mr. RAILSBACK. Very good. That's all I have, thank you.

Mr. BRADLEY. I think you will find, Mr. Railsback, that on each of those pages we anticipated the subcommittee's need for this information. We did extensive research in anticipation of the question you asked.

If you or any of the other subcommittee members or staff want additional information on that, I will be happy to provide it for you.

Mr. BUTLER. Do you want to finish this line of questioning now, or do you want him to finish his testimony first?

Mr. KASTENMEIER. I think the rest of us may withhold until he concludes.

Mr. RAILSBACK. I apologize for leaving, but I wanted to ask that question. I think this does answer my question.

Mr. BRADLEY. Thank you, Mr. Railsback.

As mandated by Congress, each of our local programs is governed by a board of directors. At least 60 percent are attorneys and members of the bar of the State where the program operates. At least one-third of the members of the board are low-income people. These boards serve a crucial need in seeing that the programs develop delivery services that best respond to local circumstances.

You will recall that Congress in 1977 amended the Legal Services Corporation Act, mandating that each local program adopt procedures for determining priorities for the provision of legal services in that particular community. In setting these local priorities, programs must look to the legal needs of eligible clients in the areas where they serve. The priority-setting process is an opportunity for individuals living in the area to voice their opinions as to the types of cases on which they believe the program's limited resources should be concentrated. While Congress, the Corporation and its regional offices provide general guidance, technical assistance, and oversight, these programs are in fact directly controlled and accountable to their local communities.

As a result, you will see legal services programs vary greatly, reflecting the nature of the client community they serve. I don't have to point out to you, for example, that the program that serves the Navajo Indian reservation comprising large areas of four Southwestern States varies greatly from the program that serves the inner-city residents of Boston. What they all have in common, however, is their commitment to providing high-quality, effective legal services to their clients.

Local programs represent mothers with small children who have been abandoned without support. They represent elderly persons who live alone in deplorable housing conditions, minimum-wage earners with families whose income is garnished because of consumer fraud, and children who are not being properly fed because of erroneous denial of public-assistance benefits.

It is possible from the information that we have gathered to develop a national picture of the types of problems being addressed by legal services programs if you would again look to the middle chart, chart 2, entitled the "Distribution of Cases Closed, by Problems."

You will see from looking at the chart that the largest category of cases, representing approximately 30 percent of the total, is designated "family," which includes routine adoptions, custody, divorce, support, paternity, parental rights, spouse abuse, and other family-related matters.

Income maintenance and housing are the next largest categories, each representing between 17 and 18 percent of the cases. Housing includes not only landlord-tenant disputes but homeownership and federally subsidized housing rights, other housing issues as well. Income maintenance runs the gamut, including AFDC, food stamps, social security, SSI, veterans benefits, and black lung benefits being primary examples.

Looking at the rest of the chart, consumer issues make up approximately 14 percent of all cases and cover such things as contracts, warranties, credit, debt collection and public-utility matters.

A grouping of education, juveniles, health, individual rights, and employment cases constitute another 9.4 percent of the pie chart, with the final 11 percent being made up of a whole range of miscellaneous cases.

For instance, one of the first cases I handled when I was a staff attorney in Florida involved an elderly lady who had a tree fall in her front yard during a windstorm. The city refused to move the tree because it was on private property. We were successful in getting the tree removed. That would be called a miscellaneous case.

One important fact which is lost in any detailing of these cases is the fact that the need for legal services far exceeds existing program capability. By using anyone's standards—and we basically use the OMB and the Department of Labor's eligibility standards—we have a potential client population conservatively estimated at 30 million clients. At most, the most that our attorneys operating throughout these 50 States would possibly see and that we served last year is 1.5 million.

We adhere to very rigid eligibility guidelines. I have visited programs, and have seen persons deemed ineligible simply because they made \$5 a week more than the guidelines we have established. Virtually every program is forced to turn clients away. Therefore, it is important to remember that these figures that I gave you represent only the present ability of our programs to serve clients, and they clearly do not represent the full extent of the needs of low-income persons.

As I mentioned previously, local program boards help to determine the priority needs to be addressed. Their experience has demonstrated that the staff attorney component is essential to the provision of a full range of services to the clients. That has been shown through the delivery systems study. However, the Corporation and our local programs have found that improvements can be made through additional private-attorney involvement in the delivery of services.

This is most efficiently carried out through the existing structure of local staff-attorney programs. Duplication of administrative costs is avoided, and our local programs perform the necessary screening and referral functions that match the needs of clients with the delivery system that best meets those client needs.

Most of our programs have successfully incorporated private attorneys in their local programs. In 1980, 96 of our programs included an organized pro bono component. Sixty-four of our local programs now contract in some way with private attorneys who are in private practice for delivering legal services to clients. Seven of our current programs operate a supplemental judicare program, and we have 10 judicare programs operating in 10 States at a level of \$3.24 million in 1980. The initial information we have gathered for 1981 indicates that the grantees are using private attorneys to a greater extent than ever before.

Recently, the Board of Directors of the Legal Services Corporation set aside one-half million dollars to be matched on a 50-50

cash basis by local bar associations to encourage local bar associations to fulfill their professional responsibility and to develop organized pro bono programs. I am happy to report to you that when we solicited proposals from associations we received approximately 70 proposals requesting \$1.4 million. We only had one-half million dollars to distribute. We made those grant announcements last week.

The Legal Services Corporation and all of its programs are dedicated to serving their clients' interests. They are the very heart and soul of this program, and we would be remiss if we failed to include the importance of the legal services in the daily lives of our client community.

The last chart that I have before you is very simple. It provides basic information about these clients. As you know, legal services currently are available only to persons who are financially eligible—\$4,700 or less for a single person and \$9,300 or less for a family of four.¹ An income of under \$10,000 per year does not allow payment for the services of a private attorney. We cannot fail to recognize that a person or family with such an income would simply be denied legal assistance but for the local legal services programs.

If you want to look for a moment at that chart, it indicates, the age group of clients served. As you can see, one most widely represented are persons between the ages of 18 and 59. Persons over 60 represent about 30 percent of our total case load.

You will see at the bottom of that chart that 54 percent of the clients we serve are whites. Blacks are the next largest percentage, and then Hispanics and the others.

In the next month, you will be hearing testimony from many of the clients we serve. You will also hear from many of the lawyers and other persons involved in legal services. I would hope that each member of this subcommittee will, if you have time—and I know some of you have—will visit the local legal services programs in your district. I urge you to meet with those lawyers, those board members, those clients, and to see for yourself the types of services that are being provided in your local community. We think that this is critical and will help in your consideration of the legislative issues you will be addressing during this session of Congress.

I am pleased to provide you, Mr. Chairman, with this background information. As you know, I will be more than happy to provide your staff and the other subcommittee members with any additional information.

I would, Mr. Chairman, if you would allow me, like to say, that I feel at home when I appear before this subcommittee, because there would not be a legal services program as I described today but for the leadership of this subcommittee, especially the support given by you, Mr. Chairman and Mr. Railsback. I want to pay special thanks for the work of your staff because they are in almost daily contact with the Corporation staff and myself. I think we have developed an extraordinarily good working relationship.

I would like to welcome Mr. Butler back to the subcommittee.

¹EDITOR'S NOTE.—Subsequent to the hearing—on May 4, 1981—the eligibility standards were changed, as they are annually updated with the OMB poverty level, to \$10,563 and \$5,388, respectively.

Mr. Frank, it's nice to have you in the Congress, especially as a Member of the subcommittee. We look forward to meeting with you and working with you personally during this session of the Congress.

Thank you, Mr. Chairman.

Mr. KASTENMEIER. You didn't mention Mr. Sawyer.

Mr. BRADLEY. He's an oldtimer. He was with us last year. It's always good to have Mr. Sawyer back.

I saw John Cummiskey at the American Bar Association, and he went out of his way to say, "You go and tell Mr. Sawyer that I saw you."

Mr. SAWYER. He's my campaign chairman.

Mr. KASTENMEIER. We compliment you on your presentation. It is very complete, considering the wide range of programs.

I have a number of questions, but I will first yield to Mr. Sawyer, I guess.

Are you senior on your side?

Mr. SAWYER. Yes.

Mr. KASTENMEIER. Mr. Butler?

Mr. SAWYER. Mr. Butler says by about 20 years. [Laughter.]

I want to make clear that we do not have the problem of social activism in our area. I'm sure it would have come to my attention if we did have. However apparently in some areas the recipients of the funding go out and try to pursue their own social causes rather than handling the nuts-and-bolts legal problems of their clients. You would be surprised how many complaints I get about that type of activity from other Members.

As I read your summary about the makeup of your board, I can kind of see that the majority of them probably wouldn't be very interested in curbing that kind of activity. Can you throw any light on this? Is there anything being done to try and prevent this kind of social activism?

Mr. BRADLEY. Mr. Sawyer, I think you probably quickly went to the part of the issue that probably caused more debate and more discussion and, in some instances, more opposition to legal services than anything else. I encounter it every day from bar association presidents, from Members of Congress, and in letters that cross my desk.

I must admit, in our own defense, I think that the examination of the facts and the records just do not support the charge that most attorneys from legal services spend most of their time and most of their money on personal crusades of social activism and social idealism.

Mr. SAWYER. I haven't heard most of them. But apparently, in enough areas—and I basically am a supporter of the Corporation—

Mr. BRADLEY. I understand.

Mr. SAWYER. I would like to get some good answers or some assurance regarding these changes of social activism because even though they may be a small, overall minority, they are numerous enough. It's on this issue that I'm hearing opposition from the Members to the funding of the Corporation.

Mr. BRADLEY. I think there is an excellent system of checks and balances. Congress decided that these programs would be locally

based and locally controlled programs. There's not a legal services program operating anywhere that does not have 60 percent lawyers. In most instances, these lawyers are appointed by local bar associations and other groups in that community.

I think the check and balance system that Congress worked out addresses the issue as to whether or not there is this level of social activism that some people allege. I know for example, that Howard Phillips and most of the accusations he makes against this program concern so-called social activism. He has organized the National Committee to Abolish Legal Services.

He starts out in all of his mailings, "we've got to put a stop to social activism." I submit that it's a misperception, that 99 percent of what our attorneys do are precisely what I explained to you in my testimony. Yes, there may be a case filed by an individual attorney in a particular community. I can tell you that a client came into our office with a legal problem. It was a civil legal problem. It was the type of problem not prohibited by this Congress. And they met the financial eligibility stands established by Congress pursuant to our OMB guidelines.

But the filing of that lawsuit in some person's mind is not what they would consider just routine day-to-day uncontested divorces. They think that it challenges the establishment. They think it attempts to put the local bank into receivership. They think we branch out into areas that Congress never intended that we involve ourselves in.

I don't know how to avoid that problem. I recently went to a rural section of Texas and met with the local bar association president, Congressman's aide and the mayor. We talked about the 3,000 cases that that program had been involved in, 3,000 cases. There were only 2 cases out of 3,000 that the mayor and the city council says that "you all should not be involved in." They passed a resolution calling on Congress to prohibit the further funding of legal services because of those two cases.

I would submit those two cases to any independent lawyer, any Member of Congress for examination of their merits. I guarantee you that you would conclude those should have been filed.

One of them was filed against the city water department because it unilaterally turned off people's water. There was an elderly lady whose water was turned off because she had allegedly not paid a \$108 water bill when, in fact, she had paid it.

The fact that the program filed that lawsuit shocked the city. They said, "You have no business doing that." The program tried to resolve the matter with the city manager and he said, "All of these deadbeats are trying to get out of paying. We had no choice."

A State court ruling prohibited the unilateral turning off of people's water. We filed the lawsuit and we were accused of stirring up trouble.

When I said to the mayor, who happens to be the president of a local bank, "I cannot believe you want us to close the program just because of those two lawsuits." He said, "Congress never intended for you to file these lawsuits against this government entity." I said, "Congress did intend for us to represent the interests of those clients even if it means filing a lawsuit against the city of Nacogdoches, Tex."

Mr. SAWYER. What do you mean by minimum access?

Mr. BRADLEY. It was very simple, Mr. Sawyer. Referring back to this first map that I provided. When the Federal Government funded programs from 1965 to 1975, and I was part of OEO some portion of that time, we basically gave money to local communities that requested the money. As a consequence, we had an inequitable distribution of funds.

When the Congress created the Legal Services Corporation, the few of us who were working with the Corporation basically developed a very, very, very simple formula. It was predicated on what we call an equitable distribution of funds.

We figured that in every community, we needed to have a minimum of two lawyers for every 10,000 poor persons. We costed out what that would cost in 1975 dollar terms. We figured it would be \$35,000 per attorney. That includes the attorneys' salaries, the secretary's salary, the rent, law books, overhead, which came to \$75,000 for the two attorneys in a given community, multiplied by 10,000 poor people. That came out to \$7 per poor person.

We came before the Appropriations Committees of this Congress, to this oversight committee and our oversight committee on the Senate side and said, "What we would like to do is go from this map to this map and to do so will cost x number of million dollars." It's that plan that the Appropriations Committee says, OK, we'll support that and offer a 4-year period, you've given us \$100 million—

Mr. SAWYER. Is 1 lawyer per 5,000 anticipated?

Mr. BRADLEY. I go out of my way trying to say the concept of minimum access. It's bare minimum.

Mr. SAWYER. Was everybody who wanted to see a lawyer who is in this category able to see one?

Mr. BRADLEY. Absolutely not.

Mr. SAWYER. What percent of those who are in this category who want to see a lawyer are able to when you use the term "minimum access?"

Mr. BRADLEY. The 1970 census figure showed that there were 30 million poor persons. Last year with minimum access in every community we could only serve 1.5 million. So there were 28.5 million who, if they walked into our office and said I need a lawyer, we couldn't serve them.

Mr. SAWYER. I don't know what happens in the general population and I wonder does everyone who opts to walk in with a legal problem get turned away because there is no one to see them?

Mr. BRADLEY. Yes, sir.

Mr. SAWYER. That would still be minimum access?

Mr. BRADLEY. Yes. It means we have two lawyers sitting in that office. I was in a program recently where they have a waiting list of 9 months before a client can see a lawyer unless it is a divorce. What if it's a divorce? In Volusia County, Fla., you go on the waiting list and in 9 months, they'll call you in for an appointment.

Mr. SAWYER. I know we have had a legal aid society in my area for many years. It was totally supported locally, especially by the law firms and the lawyers, but also by the United Fund and before that the Community Chest.

Now, I looked at their records. That local support has substantially dried up because of the Legal Services Corporation. Is there some way the thing can be handled so that it does not discourage local funding where it's available?

Mr. BRADLEY. Yes, sir. You gave me a good opportunity to tell you about a visit to Dave Stockman's former district, in Michigan. We had that very situation. In Cass County, Mich., they were spending a number of dollars from general funds for legal services using law students from Notre Dame. We were going to fund at the minimum-access level, 2 lawyers per 10,000.

The county was opposed to our funding, since the county was funding the existing program.

Mr. Stockman asked me to meet with the county commissioners and I spent a couple of days there. We worked out a cooperative arrangement where the county commissioners' funds are being used to provide criminal defense work, which we're precluded by statute from doing.

Then the meager funds, \$38,000 that we're spending in his community, support the civil side of the program. In that community, we were able to maintain it.

It's happened, Mr. Sawyer, where local communities that have charitable funds, see that there are Federal funds for legal services. The availability of Federal funds allows that community to allocate funds to meet other critical social needs that were previously not met.

All of our programs are encouraged to go out and seek other funds. Many of them are successful. I can show you the profiles of some of our programs that have 10 different funding sources. The United Way, private foundations, other Federal funds, for example, Administration on Aging money, title XX money, go into local legal services programs and supplement the minimum level of services.

Mr. SAWYER. Thank you, Mr. Bradley. Thank you. Mr. Chairman.

Mr. KASTENMEIER. Thank you. We greet the new member of the committee and call on him for any questions he may wish to ask. The gentleman from Massachusetts.

Mr. FRANK. Thank you, Mr. Chairman. I was a consumer of legal services. I was slightly above the eligibility line. But I did a lot of referring of people who would come to me for various problems.

Maybe I'm one of the people who is guilty of leading legal services' people to temptation, but people who were in legal services were a useful source of information as a legislator. So I would send people there and, in that regard and as a source of information, I found the program useful.

My general question, we're told in part by some people that we don't need legal services because the private bar would be able to take care of this. I'm wondering, you talked about a place where you've got a waiting list of 9 months. Has anyone told the private bar that they can't participate if they wanted to, to share the work load?

Mr. BRADLEY. Mr. Frank, a major effort of the Corporation for the last couple of years, and increasingly it's going to occupy much of my own time, is to involve the private bar. I recognize, especially

in 1981, that the Congress is not going to give us much more money, period.

Mr. BUTLER. Not much more.

Mr. BRADLEY. I would be naive to believe that you're going to give us huge, huge increases to serve—

Mr. FRANK. But maybe you need to arm yourselves.

Mr. BRADLEY. Realistically, that means that those clients are not going to be served by our programs or private lawyers donating their time pro bono. The Corporation is doing everything it possibly can do to increase private bar involvement.

Mr. FRANK. How much do you think you are going to be able to get out of them?

Mr. BRADLEY. It's going to vary. Reese Smith, the current president of the American Bar Association, has made one goal for his term in office and that is the expansion of legal services to those persons being unserved. There is not a week that goes by that he does not go to a local bar association.

Last week he was in De Kalb County, Ga., pleading with them to establish a structured, free pro bono program. He went to the board of governors of the American Bar and got \$70,000 to set up pro bono—

Mr. FRANK. This is complimentary to legal services. You're saying the organized bar is not holding back because—you know, not saying let those guys take care of it?

Mr. BRADLEY. If I had to give you a picture, I would say that it's a very small minority of State and local bar associations that, as a matter of commitment of that bar association, has said, "We believe in having a program to meet the unmet legal need."

I can name them. Boston voluntary lawyers project is one of the best.

Mr. FRANK. People who have suggested that that's your fault, that it is the presence of this Government program that upset the initiative of the private sector. What about before you?

This map. This is the map of what it was like?

Mr. BRADLEY. Federal funding by OEO from 1965 to 1975.

Mr. FRANK. What did it look like with private coverage of that? What was the status of help for poor people before you got there?

Mr. BRADLEY. I was the Regional Director for Legal Services for the deep South during much of that period shown on the map. I can tell you today for 1981, there's huge, substantial, quantum leaps in private bar participation and legal services for the poor as compared to any time previously.

Mr. FRANK. You think the effect of this program has probably brought forward more—

Mr. BRADLEY. There's no question.

Mr. FRANK. You cited a couple of cases that people regard as inappropriate lawsuits. To what extent are the complaints, and criticisms, inappropriate lawsuits, and to what extent are they intervention of the legislative process? To what extent are you accused of lobbying and forgetting about lawsuits altogether?

Mr. BRADLEY. Mr. Sawyer identified one sensitive area and you've just identified the other. I suppose those two areas are the most sensitive in terms of what I hear and the matters that this

subcommittee and other Members of Congress bring to our attention.

Many members of the public and especially local attorneys, say that our attorneys should not in any way, shape or form or fashion be involved in what I would call legislative representation and others would call lobbying.

The provisions of the act, and we think clear legislative history, under section VII of the act that this Congress passed, does prohibit our attorneys from engaging in lobbying efforts. But it makes clear exceptions to that.

When we're representing a client and the appropriate representation of that client takes us to the legislative body, then that's appropriate. You have identified yourself, where as a member of a legislative body requests that we provide assistance, and that happens in numerous instances.

The third exceptions that this Congress has made to the restrictions on lobbying activities—when it's a matter that directly affects the Legal Services Corporation or that local grantee. If you were to ask, what is the volume of complaints about lobbying activity, I don't have that number. I could get them for you. I'll tell you it's a very, very small number of complaints in a year's period of time that I get from Congress or from local officials about lobbying activity.

The largest number of complaints that my office gets is that we're representing an over income client, somebody who makes too much money. Those are the easiest for us to investigate and verify.

That plays off against the question that Mr. Sawyer raised. Our attorneys don't want to represent anyone over income because the 30 million out there that we know are eligible, we're not able to represent them.

Mr. FRANK. How many complaints have you got from members of State and local legislative bodies that they have been improperly approached?

Do you get many of those? Do people call up and say, tell your people to stop giving me all this information?

Mr. BRADLEY. Very, very few. If I went through quickly in my mind, it would probably be less than 10 in the period of a year.

Mr. FRANK. I would be interested in knowing. I would be interested if there was any substantial sense by the legislators themselves.

Mr. BRADLEY. I can document that for you. [See app. 2(A).]

Mr. FRANK. When you talked about suing Nacogdoches, Tex., and you talked about a woman who was having trouble with a water bill. I gather that you are somewhat underlawyered; 1 lawyer for every 5,000 people.

Coming from Boston, that's an extraordinary statistic. I think we have one lawyer for every seven people. It is a problem when you have too many law schools.

But one of the objections that is being brought against you is that you are bringing too many class action-type suits, too many suits which go beyond the immediate concern of the immediate client.

If you were going to go back to the case-by-case adjudication and simply trying to get the money back for the lady and not fight these suits, what would that do to your workload?

Mr. BRADLEY. I think it would be devastating. I think it is sound, efficient utilization of very, very scarce resources for us, say, in Nacogdoches, Tex., to file that class-action suit.

In fact, most of our class-action lawsuits are in the area of factual, legal problems that many, many clients are faced with. Whether it is a governmental entity at the local level, or a loan shark or a furniture company, it makes sense, rather than file 20 or 30 individual lawsuits, it makes sense to file the one class-action lawsuit.

But, even given that, the number of class-action lawsuits filed, compared to the total picture, is very small.

But it is those few that we do file that cause us unbelievable consequences.

Mr. FRANK. Thank you.

Mr. KASTENMEIER. The gentleman from Virginia, Mr. Butler. We welcome him back to the committee.

Mr. BUTLER. Thank you, Mr. Chairman. It is nice to be back.

Mr. Bradley, apropos of the complaint about inappropriate lawsuits, you are familiar with what's called the sweetheart lawsuit—concerning Community Services Administration?

Mr. BRADLEY. I'm familiar with it, because I read about it in the Wall Street Journal.

Mr. BUTLER. That's the article I'm talking about. It was brought by a legal services attorney, was it not?

That was my understanding. According to the Wall Street Journal article, there were nine plaintiffs in the class-action suit.

Of the six plaintiffs reached for comment, three professed no knowledge of the lawsuit and only one said he was consulted in advance.

Moreover, those who were aware of the lawsuit at all alleged they had been steered into the lawsuit by public-interest law firms. I am telling you something you don't know?

Mr. BRADLEY. I have read that article, Mr. Butler. If you will permit me, and I don't say this lightly, I think that article contains absolutely, grossly, factually incorrect information.

We have prepared and we made it available to other Members of the Congress who have requested it, a very detailed, comprehensive factual response to all of the issues involved in that lawsuit.

If you will permit me to deliver that to your office this afternoon and if you would read it, I think you will conclude that maybe this reporter didn't have all the facts when he wrote his article. [See app. 2(B).]

Mr. SAWYER. Will you send me a copy?

Mr. BRADLEY. Yes.

Mr. BUTLER. Can you give me a highlight so I don't have to read the whole thing?

Mr. BRADLEY. Yes.

Mr. BUTLER. We—I got the same kind of response from the Community Services Administration. They wrote me back a long letter, detailing what a terrible thing they have been saying about them in the press.

I couldn't help reminding myself that the judge reversed the decree. It seems to me there must have been some error.

On yesterday, we had hearings in the Government Operations Committee. I asked the people in my office to alert you to the fact that I might ask some questions about legal services.

Are you familiar with what took place on yesterday?

Mr. BRADLEY. Yes, sir.

Mr. BUTLER. I hope you have a response to the questions that were raised there.

Just to make a record, are you familiar with Circular A-73, Audit of Federal Operations and Programs, issued by the Office of Management and Budget?

Mr. BRADLEY. Yes, sir. I have it in my hand. [See app. 1(D)(2)(i).] I think, as a matter of fact, I have both of those.

Mr. BUTLER. All right.

On page 44 of that GAO report, there is a little report card at appendix 3 and the topic is compliance with policies and procedures of OMB, policies and guidelines.

It has a row of X's indicating that you have failed to meet the standards of A-73 in every instance they inquired about, except the last column, which has a footnote saying that they could not determine.

I hope you have an answer for that. What they turned up yesterday in the Government Operations hearing is that we are letting an awful lot of Federal funds get away from us because of unresolved audits.

If my reading of this report is correct, the Legal Services Corporation is a major offender.

I am sure you would like to respond to that.

Mr. BRADLEY. I very much would like to respond to that.

The Director of Audits for the Legal Services Corporation, a CPA, who for years was with Arthur Anderson & Co., is with me and I asked him to be in attendance at the Government Operations Committee oversight hearings yesterday.

He took extensive notes and heard your questions and the response from the witnesses. He has prepared for me a fairly brief response.

He's in the process of preparing a much more detailed response, which I would like to submit to this committee.

I would like to, for the record, say a few things—

Mr. KASTENMEIER. We are at a disadvantage in this committee, since the gentleman from Virginia alludes to a document that this committee does not have, and of which it has no knowledge.

Your response to it may be useful only in the context of having the report also a part of our record. [See app. 1(D)(2)(b).]

We will try to obtain that. I don't know for whom this particular GAO report was prepared or what significance it has.

Mr. BRADLEY. Mr. Chairman, if I could—because we just received it ourselves a couple of days ago, as a matter of fact, I saw it for the first time yesterday.

We got it in the mail from Chairman Brooks, I think, on Monday of this week. We were reviewing it when the questions came up yesterday.

So, we are almost at the stage that you are. But I think it is very, very important. I want to be responsive to Mr. Butler's question.

But I want to say this: There are a lot of things that the Legal Services Corporation does, some that we do extraordinarily well, some we do not so well, and there are probably some things that we do poorly.

We are trying to correct those things that we do poorly. I can tell this committee that there is no matter at the Legal Services Corporation that we take more seriously, that we devote more effort and more energy to, than the sound accounting of Federal tax dollars.

I worked at OEO for 8 years, and I shouldn't use my good friends at OEO as an example. But I would match what the Corporation does to every Federal agency, every Federal program that your Controller General included here on his chart.

I want the record to reflect that the Corporation is not subject to Circular A-73. We got a request from them and we provided them information.

We called them on the telephone and said, look, we would like you to come over and sit down and meet with us and review what we are doing.

Mr. SAWYER. What is circular—I have no idea what you people are talking about.

Mr. BUTLER. That is a circular issued by the Office of Management and Budget, which requires Federal agencies to establish policies for prompt and proper resolution of audit recommendations. [See app. 1(D)(2)(a).]

And now, you can audit the hell out of things, but if you are not following up, you are not meeting the requirements of A-73.

Mr. BRADLEY. You are absolutely right. I don't want, Mr. Butler, to be argumentative. I concur exactly with what the Controller General is attempting to do.

I would invite and I wish that you would request a person from GAO to come down and visit us and look, in fact, at what we are doing. They asked us to fill out a form that they sent us, which we attempted to do.

We tried to verbalize and explain to them that that form doesn't apply to our procedures.

In the last 5 years, we have allocated \$700 million to our local grantees. That report that you have in your hand, questions \$1.9 million worth of unresolved audit costs, \$1.9 million out of \$700 million.

We require an extraordinary standard on our programs. The Federal Government gives its grantees 6 months in which to submit audit reports. We require 90 days.

We recognized that there were some deficiencies in following up. We now have a 2-month reporting requirement. We immediately notify our grantees. Within 2 months, we follow up on that.

We are consciously vigilant to make sure no costs go unquestioned. We imposed very, very detailed requirements under our financial accounting and audit guide manuals that are imposed upon our local program by regulations.

We require that they have independent CPA accounting prepared every year. This is generally the typical kind of questioned costs that you are talking about.

A local program that receives Corporation funds cannot purchase equipment valued over x number of dollars without prior approval of the Corporation.

Many of them do it. They will buy an IBM typewriter. The cost exceeds by \$27 where the local auditor has no choice and he questions that cost because he cannot find a document in his file.

If that program had contacted us and said, we want to buy a typewriter, we would have approved it. They failed to do so.

It is those types of costs that are unresolved and are basically the questioned costs.

Mr. BUTLER. Are there still \$1.9 million of them?

Mr. BRADLEY. As a matter of fact, as of December of 1980, it was \$1.8 million. We are in the process now of getting those resolved. Some of them are fairly large.

For instance, we have another provision that none of our programs can engage a private consultant firm or contractor, a CPA firm.

Many of our programs, as you know, are involved in some unionization situations.

Mr. BUTLER. We are going to stop that.

Mr. BRADLEY. In Michigan, the board of directors of that program in Michigan retained a private law firm to advise the board of directors, management, on labor-management relations.

They engaged this law firm to advise the board of directors of the program. They did so without getting prior approval from our office.

Thus, that shows up as a questioned cost on the report that Mr. Staats provided.

Mr. BUTLER. How did you resolve it?

Mr. BRADLEY. I am not sure we have. Our regional office is going for documentation, what are the costs, why were they incurred, why could you not obtain free, pro bono counsel? That's the process.

The minute we get that resolved, that's subtracted from the outstanding \$1.8 million in questioned costs that we have right now.

Mr. BUTLER. I think it is a dissipation of your resources to spend all your time on management-labor relations anyway.

This says you must designate an individual who is responsible for audit work. Do you have such a person?

Mr. BRADLEY. Yes, and that person is present in the room today.

Mr. BUTLER. Did we ask for a report?

Mr. BRADLEY. Yes, sir.

Mr. BUTLER. I don't see any point in beating this horse to death.

Mr. BRADLEY. But Mr. Chairman, and Mr. Butler, I think the important question is, and I say this, there are a lot of things that I'm proud of about the Legal Services Corporation.

But the one thing that I'm absolutely unequivocally proud of is our ability to make sure that the funds you have entrusted to us are spent precisely the way Congress has indicated.

If our accounting mechanisms, have been weak in the past, we are going to improve them. We, the Corporation, just as an illustration, incur this expense ourselves.

We have a fundamental criteria visit. When we, for whatever reason, think that a local program's bookkeeping systems, check control, recordkeeping systems, are not up to snuff, then we engage one of the accounting firms, Arthur Anderson, Price Waterhouse, you name it.

We send them in to improve the financial management of that program. The most vulnerable that I could be as I appear before this subcommittee or any other committee would be if we are not accurately and appropriately controlling and accounting for those funds.

I can assure you that I will never permit this Corporation to be lax in that area.

Mr. BUTLER. I am reassured by that.

I am still a little bit upset by—

Mr. BRADLEY. I will provide you with details. Mr. Brooks, Mr. Chairman, Monday of this week, wrote me and communicated this document to me and asked me to respond to his oversight committee, to the Government Operations Committee.

Mr. Butler did indicate to me yesterday that this might come up today. So I made sure that I looked at it at least very briefly.

I will provide not only Mr. Brooks, but also this committee with a very detailed response. [See app. 2(C).]

Mr. KASTENMEIER. I would appreciate that.

Ironically, perhaps, Mr. Brooks is also a member of this committee, as is Mr. Butler, so they have really two opportunities to look at the Corporation.

This committee would like that information. We will also attempt to get the report itself.

Also, we will see whatever analysis the Government Operations Committee has made of it. In any event, we will have much more detailed hearings in the near future on authorization.

This matter, at that time, can be gone into. We would like to, I think—to the extent there is a great deal of detail involved here, we may want to satisfy ourselves as to what that detail represents.

I understand your statement that—to imply that while your Corporation does not qualify as an agency of the Federal Government, nonetheless, you cooperated with this inquiry and offered them information, notwithstanding?

Mr. BRADLEY. We definitely did. We gave them everything they requested and we asked for an opportunity to meet with them to explain the uniqueness of the Legal Services Corporation in terms of our own accounting practices and procedures.

Mr. KASTENMEIER. May I ask my friend from Virginia—

Mr. BUTLER. I feel like I have asked a lot of questions, but I'm really not through. Do you want to take your turn now?

Mr. KASTENMEIER. No. I will yield to the gentleman.

Mr. BUTLER. Yes. Just so I can understand it, in your prepared statement on page 5, you indicate that working these programs around the country are over 6,200 attorneys and 2,800 paralegals earning salaries which are generally much lower than those of their counterparts in the private sector. Now, you interjected also

the expression lower than they could earn in the public or private sector.

Have you done an analysis of what their earning capabilities were elsewhere? I have the impression that this is the employment of last resort of many law school graduates and that they are attracted by the salaries even at this low level.

Would that be an unfair statement?

Mr. BRADLEY. I think that would be a most unfair statement.

Mr. BUTLER. I appreciate your correction. You made the statement that they can earn more in the private sector. Do you really believe that? Have you got something that says that?

Mr. BRADLEY. We've got a study and I will be happy to send it to this subcommittee, where we attempted to determine our salaries versus the private sector, working for the Federal Government.

If an attorney goes to work in one of our programs today in Atlanta, Ga., graduating from my law school, Mercer, they are going to make \$14,000. If they work for the Federal Government in Atlanta, they are going to make \$23,000. If they work for the public defender in Atlanta, they are going to make \$19,000.

On any stand that you use—

Mr. BUTLER. You haven't answered my question. I understand that there are better deals elsewhere. Are there better deals available to these people?

Mr. BRADLEY. Absolutely I don't want anyone to think that the people who work in legal services do so because they can't get a job anywhere else and that we are the dumping ground for unemployed lawyers who have to choose between us and driving a taxi.

Look at the record. Most of the attorneys who leave legal services, the director of our program in Atlanta, for example just left and joined the biggest law firm in Atlanta. There is not a lawyer in legal services in my judgment today that could not go to work at substantial increases in their salaries with the most reputable law firms in Lynchburg, Va. and—

Mr. BUTLER. Wait a minute. Lynchburg is in my district.

Mr. BRADLEY. I know. We just lost one of our attorneys in our Los Angeles program and I know what he was making, and he went with a firm that made him a \$90,000 a year offer. When we advertised for jobs, if we advertise for a job in some of our programs tomorrow, we will have hundreds of applications for one job. We have law review editors. We have clerks from Federal judgeships.

Mr. BUTLER. I understand you get some real good people. I have run into them on occasion. But my question is, and I think you have endeavored to answer it, is if you sat down and looked at your cross section of people, and said are you turning down job opportunities elsewhere—

Mr. BRADLEY. I'm not the best person to answer that question on a case-by-case basis. I will provide you that information. There are quite a few project directors present here today. [See app. 2(D).]

Project directors for our programs in Kentucky, had breakfast this morning with the Kentucky congressional delegation. They, better than I, can tell you the volume of applicants that come into their doors seeking jobs. I don't think there is anyone in here that would tell you that we don't get the cream of the crop, the people

who feel strongly committed to what legal services is all about. They join legal services for that purpose.

Mr. BUTLER. All right. I am glad to hear that. Now, one more question. Lynchburg is one of those areas that you brought up and it is one of those areas where we have effectively lost the use of the private sector Legal Aid Society. I'm not going to rehash that at this moment.

But my question is, what sort of program have you got to attract more local or private funds to the support of the local legal services corporation? It's legal and it's encouraged under the law.

To follow up on that, how would you feel about conditioning the Federal grants for local legal services corporations on private or on local government participation in the program?

Mr. BRADLEY. If we condition our grants on private or local government participation, they won't give a dime and there would be no program.

If I could state it the other way around, these directors sitting in this room and others aggressively seek out funding sources from every possible source. Today as I appear before you, we award them \$321 million. On their own initiative, they obtain \$40 million from other sources, much of it from voluntary contributions from the bar associations, private foundations, United Way, categorical programs, AOA, title XX, and others the Congress has established.

The Corporation provides training seminars on grant raising. We did our first one last year on how to write grant proposals to private foundations. I don't have to tell you, Ford, Rockefeller, the big foundations are withdrawing from public service grants.

I wrote a letter recently to the McKnight Foundation in Minnesota, to support our application for the community legal education project, a local program. I got a call the other day and the foundation gave our local program the money because they felt that was a worthwhile purpose.

Our Board this year took a half a million dollars and for the first time wanted to test the hypothesis that local bar associations would give a dollar, if the Corporation would match it dollar for dollar for additional legal services, and we were successful.

As I indicated earlier, we have seen that it is successful and I'm sure we will continue to encourage those kinds of activities. I would really strongly, strongly represent to you that if you condition all of the moneys that this Congress makes available to local communities on a strictly cash match, 50-50 basis, I think that you are going to see a dramatic reduction in the level of legal services.

Mr. BUTLER. Let me bring you to another proposal, then. The Office of Management and Budget proposal is that legal funding services be part of a social services block grant which the States could divvy up among programs as they see fit.

You are an independent Government agency so you don't have to worry about sanctions from the administration or anything like that. Your Board may change character, but don't worry about that. Give me your frank assessment of this proposal and particularly how you think the States would divvy it up.

Would any States eliminate legal services if that was the proposal? If you would prefer not to answer, you can say that.

Mr. BRADLEY. Seriously, Mr. Butler, I have been in touch and have had several conversations with staff members of Mr. Stockman's staff. My Board chairman and I have asked Mr. Stockman for a meeting. While Mr. Stockman's black book, as it is affectionately called, does list the Legal Services Corporation among the programs to be consolidated into a block grant program, when the President spoke on the 18th, there was no specific reference to legal services. In my conversations with members of Mr. Stockman's staff as recently as last week, they indicated that all of the planning of OMB is to include us as a categorical grant program to be turned over in this block grant concept to the States.

We got a phone call last week from the director of planning in Secretary Schweiker's office that Mr. Schweiker's staff has been given the directions from OMB to prepare the refined package of programs to be turned over to the Governors of the respective States. This person is totally unfamiliar with legal services but legal services was on his list.

He wanted us to provide him with everything possible about legal services which we are providing. We are attempting to have a meeting with people at the White House. The American Bar Association president, Mr. Smith, has sent a letter to the White House asking for a meeting specifically to talk with them on that point. So, we are acting and we are assuming as I appear before you today that it is the intention of the administration to recommend to this Congress that the Corporation be included in a block grant concept. That's what we hear.

In my own opinion, and here again I cannot help but speak as a son of the South, and I'm proud of it. I know legal services and I know how difficult it was for us to establish legal services programs in the South. One of the bar associations in the South went all the way to the U.S. Supreme Court to try to stop Federal funding of legal services in their community.

One of our programs in the deep South is the Legal Services Corporation of Alabama. We award that program the minimum access level, but that program also received money from the State of Alabama. The State of Alabama however attaches strings to its grant, and will not allow certain types of cases to be handled and under no condition can action be brought against the State of Alabama with this money, even though it's Federal money.

Mr. BUTLER. That makes sense, doesn't it?

Mr. BRADLEY. No. It's money that you, the Congress, gave to Alabama to be administered under a block grant concept.

Mr. BUTLER. I thought you were talking about the Alabama contribution.

Mr. BRADLEY. No, sir. It's money the State controls and since they control it, they will not delegate it to us if we do these activities. So we have to limit the scope of our work.

Mr. BUTLER. You are apprehensive about what this program might do if you turn the decisionmaking over to the States as to what part of it will go to legal services?

Mr. BRADLEY. Not only apprehensive, Mr. Butler, I'm scared to death.

Mr. BUTLER. I think, Mr. Chairman, I have taken more than enough time. I thank you for your indulgence.

Mr. KASTENMEIER. Mr. Bradley, I have a series of questions here. I will try to be brief.

Could you give us a brief report on the status of your Board as of the moment?

Mr. BRADLEY. Yes, sir. We have an 11-person Board appointed by the President. Five of those Board members' terms expired on July 17, 1980. But by law, they continue to serve until the successors are duly appointed and confirmed. So we have today five lameduck Board members.

President Carter, shortly before the election recess that the Congress took last year, renominated all five of those members for another term. After the election, the Senate committee tried to confirm them during the lameduck session. I don't have to explain to you that they were held and the Senate did not act on them. As a consequence, we have five vacancies. The other six Board members, their terms all expire July 17, 1981.

So, by the early part of the summer, there is the possibility that we will have 11 new members of our Board. Five could be appointed today and the other six could be legally appointed in July.

Mr. KASTENMEIER. As far as you know, is there any intention on the part of the administration to nominate five new Board members for those vacancies?

Mr. BRADLEY. I'm attempting to find out that information. As a matter of fact, I spoke to Mr. Railsback's office the other day. His office has been in touch with the personnel director at the White House to try to determine what are their plans and intentions.

I can report to you based on that conversation that right now, I'm not sure that they know what those plans or intentions are.

Mr. KASTENMEIER. You indicate that "minimum access" doesn't actually mean access for all the poor, all the qualified individuals; that even presently many cases are deferred or are going unattended.

Furthermore, is it not the case that many local programs have decided on certain legal priorities for a community and consequently, do not handle certain cases?

Perhaps they do not deal with family matters, or landlord-tenant relationships. They have decided a competence exists in other matters, and they have decided that these should have priority.

And therefore, the poor, even there, do not have practical access to legal services in certain fields. Is that not correct?

Mr. BRADLEY. That's absolutely correct.

In the priority-setting process by local boards, Mr. Chairman, many of our programs have simply determined that they cannot handle divorces, period—unless there is maybe a custody situation or an extraordinary reason for doing so, because they cannot serve everybody who walks in.

Thus, they unfortunately have to deny people representation. I wish, Mr. Chairman, that one of these days I could come before you and present a plan called maximum access to justice.

But unfortunately, maximum access is going to cost a lot of money. It is going to involve new ways to administer justice. It is going to involve, for example alternative dispute resolutions. We are going to reform courts, figure out new, different, innovative, ingenious ways to make sure that people get their legitimate griev-

ances resolved. I hope the Corporation can be a part of that, as we go forward toward that goal.

Mr. KASTENMEIER. I don't know about the term "maximum access", but I would be interested in your projecting something perhaps known as "normal" or "reasonable access" that exceeds "minimum access", and perhaps doesn't purport to cover everything. There has to be some goal, perhaps short of "maximum access" to which in other times we might well have pointed.

Mr. BRADLEY. We have a couple of task forces addressing precisely that question. I will be happy to provide you with what we now know and how we now feel about that issue.

Mr. KASTENMEIER. Fine. Even with reference to that which you now undertake to do collectively through all the programs in the United States, with the 9,000 lawyers and paralegals, it would also be of interest to me, not only in how you spent \$321 million last year or this fiscal year, but also what it might have cost if the same legal work was done on behalf of the same constituency, if there were not legal services to handle it.

That is to say, equating it with a local or vouchered service, dollar for dollar, not necessarily judicare plan. What I'm saying is I would like the \$321 million contrasted to that which the same legal work, in normal practice, would have cost collectively the recipients.

Mr. BRADLEY. I think we can provide you with some good projections. We won't guarantee accuracy of them. But I understand what you are asking. We had to deal with that in the delivery systems study. We can draw on those results. I will get that to you very shortly. [See app. 2(E).]

Mr. KASTENMEIER. It will be useful because I think, not necessarily contrasting it with that in and of itself.

But, it would be useful in suggesting cost efficiency of the staff attorney, program attorney model that is used widely in the system with what it might have cost. I think that would be useful.

You have a number of other problems. Of course, I don't expect you to discuss them all here today. We perhaps will have a further discussion of some of the problems. I will ask you to add those problems to which I have not referred.

There is the problem of representing, illegal aliens or other aliens. There is the problem of unionization, organization of attorneys and paralegals. There is the question of whether or not they could strike. We view that area as a sort of a problem.

You have mentioned a series of them. Complaints about vigilant, perhaps or aggressive representation of clients, and the counter-reaction that that understandably, I suppose, produces.

You also mentioned one further problem, the problem of competing legal representation organizations in a given area in terms of funding. That has been a problem in the past. It is still a problem today. You have perhaps an additional legal aid group that purports to represent a group or the community, as opposed to another, perhaps more aggressive group of legal assistants and what that involves. We have talked about lobbying. We have also talked about some of the other questions here today.

Are there some of the problem areas that I haven't mentioned?

Mr. BRADLEY. I think you have hit all of them, Mr. Chairman. When you were going down your list, I was also doing a quick mental check-list.

Clearly the type of problems that we hear most talked about, and that concern Members of Congress and the public at large, have been covered.

Mr. KASTENMEIER. Very often, you as an entity have a different relationship, or a different interest sometimes, than your local programs, even though you are part of the same system.

Where are you left today, with respect to the question of organization of legal services, both professional and nonprofessional? Do you have any position other than to follow whatever law pertains to such people?

Mr. BRADLEY. On the issue of the labor-management question?

Mr. KASTENMEIER. Yes.

Mr. BRADLEY. It is clear, and I'm not the resident expert on this. Those people are present in the room.

But basically, and I'm sure you will address this matter in your three days of hearings scheduled for next month our local programs basically are governed by the NLRB. It is the NLRB that's the participant in resolving the labor management issues that come up in the context of recognition of a unit as a collective bargaining unit, the certification of that unit, the collective-bargaining process.

The Corporation, is not an active participant in that, but we are very, very interested observers. The director of field services in charge of all of our field programs has been interested in having several meetings with representatives of the management of our local programs, and representatives of unions in those local programs, trying to establish some constructive dialog, identifying what the critical problems are.

I can tell you that what we are doing is providing encouragement and providing technical assistance, to make sure that even though the NLRB recognizes legal rights of employees to organize and bargain collectively, that it is done in a way that it is not destructive to the purpose of legal services; and that it does not tear asunder that whole program.

Unfortunately, we have had a few situations, thus far a very few situations, where that labor-management process at the local level has been, in my judgment, unpleasant. Mr. Rodino, your chairman and I talked about one in his district.

That was the exception, rather than the rule, but it is a very sensitive subject. It is something that the Corporation is going to try without violating NLRB, try to facilitate the best way we possibly can.

Mr. KASTENMEIER. We all know that—we used to talk about Legal Services Corporation essentially in terms of growth. Can you tell me, due to inflation or for other reasons, if any of your programs or offices have in fact closed this last year, or if there is any trend in that connection?

Mr. BRADLEY. I'm not sure, Mr. Chairman, if I will be able to document it. But I can certainly represent to you verbally now, and supply you with additional information. [See app. 2(E).] Last year we gave our programs 5-percent cost-of-living increases.

This year we gave them 6 percent cost-of-living increases. You know what Federal employees got this year was 9.1 percent. You know what the rate of inflation was last year. Many of our programs either limited their employees to a 5-percent increase and in some instances programs closed an office or by attrition and not filling positions, were able to give their employees a 9-percent or 10-percent increase.

So by that process, I think that I can accurately, without much hyperbole, represent to you that the impact of inflation on our programs in the last few years, and our failure to give many of our programs cost-of-living increases, comparable to what private sector and public sector and Federal employment is, has had a very negative effect on legal services.

I can personally tell you this, if you will permit me this one digression, and I am reminded because the program director from Louisville, Ky., is in the room.

From 1970 to 1975, the Federal funding for legal services was frozen at \$71.5 million. Every program, including my good friends in Jefferson County, Louisville, Ky., were funded at that level.

In 1970 they had nine offices in Louisville, located throughout Jefferson County. In 1975, they had one office.

Atlanta, Ga., which is my home, had eight neighborhood offices. At the end of that period of time, with no increases in funding, they had three offices.

They retrenched and saved the overhead, consolidated secretarial pools, and shut out their library subscriptions. You can understand what impact another period of static funding and no increases in our funding is going to mean. It means that we will have fewer offices, employing fewer attorneys, who will serve fewer clients.

Mr. KASTENMEIER. That suggests to me that the access, minimum access or whatever, is eroding, if anything.

Obviously, if you have seven neighborhood offices, that sort of access is an awful lot better than having three offices in an area or in a community.

Mr. BRADLEY. As you know, because you have heard from me before, my friends in PAG, the leadership of the programs in the field, are saying you have got to impress upon the Congress that minimum access is based on 1970 and 1975 figures.

I think the figure we are using now is that we have 1.7 attorneys per 10,000, based on current inflation factors.

Mr. KASTENMEIER. How soon can you give us information based on 1980 census figures?

Mr. BRADLEY. I'm not sure, Mr. Chairman, when we will be able to work that out. I suppose it will probably be mid or late this year before we will be able to give you that information, clearly not before your oversight hearings in March.

Mr. KASTENMEIER. I think we will defer other matters until that oversight hearing in March. It will also be on oversight and organization. I hope at that time—I would encourage you to be specific at that time in terms of optimally what you would like to see in the law for effective operation of your corporation.

Obviously, we may be very far from achieving that. That may be quite another matter. But nevertheless, I think you should represent what you and the Board feel in view of your priorities and

your goals, what you feel can best permit you and your successors to achieve these purposes through legislative change.

Mr. BRADLEY. The Board of the Corporation are meeting here in Washington next Friday and Saturday to vote on a specific recommendation to this committee in terms of our authorization bill for this year, which will include specific dollar amounts that we will make a recommendation to you. So we will have that ready for you as of next Friday.¹

Mr. KASTENMEIER. It goes without saying that many of the issues raised by other members, including the possibility or prospect of block grants and other questions will be raised and must be obviously addressed.

Mr. SAWYER. Mr. Chairman, are you finished?

Mr. KASTENMEIER. Yes; I yield.

Mr. SAWYER. I had one or two more questions. I'm trying to get a handle on this concept of minimum access. I would have some question in my mind whether families living on a \$10,000 to \$20,000 a year range, have much access, either.

Sure, they have access if they want to go pay for it, but they are not worried about setting up a trust or some of the business-oriented or estate-oriented type problems.

I would guess that their problems would fall almost directly in the same categories. I would like to get some comparisons of what the relative access of those below the \$10,000 using free services is compared to those, say, from the \$10,000 to \$20,000 income bracket, who, as a practical matter have to pay for their assistance.

That would enlighten me a little better as to how much access you mean by minimum access.

Mr. BRADLEY. I will try to get the subcommittee that information. The American Bar Association and the American Bar Foundation have attempted to make some projections in that area. I'm not well versed probably as I should be, but whatever I can get I will share with this subcommittee [See app. 2 (F) and (G).]

I saw a figure in yesterday's paper I think attributed to OMB. I'm not sure—but I think it said 70 percent of the people in America have incomes of less than \$20,000 a year, 70 percent.

So 70 percent of 200 million people, about 150 million people plus. I would say \$20,000 a year for a family of four or whatever probably is in effect, those people are not given effective access to counsel.

I think that's one of the reasons this subcommittee and the full Judiciary Committee have been dealing with proposals like alternative dispute resolutions and trying to figure out ways to reach those above the poverty threshold.

There are many who view the move toward prepaid legal insurance as an effort to try to bridge the gap between those who can afford it and those that receive services through the Legal Services Corporation.

Mr. SAWYER. I get the feeling not just on this program, but on many, many other programs that you are almost better off if you are classified as poor than if you are classified as low income, let's say \$10,000 to \$20,000.

¹EDITOR'S NOTE.—The Board recommendation was \$400 million fiscal year 1982; \$450 million fiscal year 1983; and \$500 million fiscal year 1984.

Those are the ones that aren't eligible for anything and they haven't got much money, either, certainly not to go see a lawyer. They try to work out their own problems, whereas if they could go to a lawyer free, they might be in a different position, even if they had to wait in line.

That's really what I wanted to know. Are the services rationed about the same when we talk about minimum access?

Mr. BRADLEY. I will try to get as much information as I can and provide it to the committee.

Mr. SAWYER. Your Washington staff here, did they get a cost-of-living increase?

Mr. BRADLEY. I didn't understand the question.

Mr. SAWYER. Did your Washington staff here get a cost-of-living increase?

Mr. BRADLEY. Yes. There are local grantees with boards of directors. We give them, in effect, a block grant at the minimum access level. How that local board apportions the money, meaning how many of attorneys, how much to pay for this, how much salary, that is decided by that local board, not by Washington.

Mr. SAWYER. The Washington staff. I just wondered.

Mr. BRADLEY. Yes.

Mr. SAWYER. How much?

Mr. BRADLEY. Lower level employees, support personnel, I prefer to call them, got a higher rate of increase this year than the management personnel that you see sitting in here.

Some of them got nothing. I got nothing.

Mr. SAWYER. What was the rate of increase?

Mr. BRADLEY. The maximum was 9 percent. Some got 2, 3, 9, 1.

Mr. Sawyer, I got nothing.

Mr. SAWYER. Neither did I. [Laughter.]

Mr. KASTENMEIER. Probably the lion's share of the people who work at Legal Services make less than \$20,000 a year.

Mr. BRADLEY. Definitely.

Mr. KASTENMEIER. They would be in the category that Mr. Sawyer talked about.

That concludes today's hearing. We are grateful to you for an excellent presentation. We hope to see you again soon.

Until then, the subcommittee stands adjourned.

[Whereupon, at 12:05 p.m., the hearing was adjourned.]

APPENDIXES

APPENDIX 1

LSC MATERIALS GENERALLY AVAILABLE AT
FEBRUARY 26, 1981 HEARING

- A. Statement of President Dan J. Bradley (including Charts I, II and III).
- B. Legal Services Programs Map, 1976.
- C. A FACT BOOK--Characteristics of Field Programs Supported by the Legal Services Corporation (February 1981).
- D. Audit Matters:
 - (1) Price Waterhouse & Company, Audit of L.S.C. completed November 19, 1980.
 - (2) Honorable Jack Brooks, Chairman, Committee on Government Operations, letter to Honorable William F. McCalpin, Chairman, L.S.C., dated February 19, 1981, including:
 - (a) OMB Circular A-73.
 - (b) Excerpts, G.A.O. Report, Disappointing Progress in Improving Systems for Resolving Billions in Audit Findings (AFMD-81-27, January 23, 1981)

APPENDIX 1(A)

TESTIMONY SUBMITTED
to the
SUBCOMMITTEE ON COURTS, CIVIL LIBERTIES
AND THE ADMINISTRATION OF JUSTICE
COMMITTEE ON THE JUDICIARY
UNITED STATES HOUSE OF REPRESENTATIVES

by
Dan J. Bradley, President
Legal Services Corporation

February 26, 1981
Washington, D.C.

I. Introduction

On behalf of the Board of Directors and staff of the Legal Services Corporation, I am most grateful for the opportunity to appear before you today to report on the status of the Legal Services Corporation.

The Corporation has been a unique and, I am convinced, a remarkably successful experiment in the administration of public funds. The statutory approach Congress developed in 1974 has not only protected the political independence of legal services, it has made possible a very simple administrative structure that has avoided the levels of bureaucracy and red tape that seem to plague so many programs for which Congress appropriates funds.

As you know, the Legal Services Corporation is a private, nonprofit organization established by Congress in 1974 to ensure that poor people are provided equal access to our system of justice. We are independent of the Executive branch, governed by an 11 member Board of Directors appointed by the President with the advice and consent of the Senate. We are chartered under the laws of the District of Columbia, and operate in accordance with the provisions of the Legal Services Corporation Act (P.L. 93-355, as amended by P.L. 95-222), and regulations (45 C.F.R., 1600 et seq.)

The Corporation is subject to an annual financial audit conducted by nationally reputable and independent certified public accountants. For the fifth year in a row, we have the pleasure of presenting to Congress and the public a clean and unqualified audit report, attesting to the financial health and stability of the Legal Services Corporation.

It is with great confidence and pride that I can report to you today that the Legal Services Corporation is financially

sound, administratively efficient, and programmatically effective. Congress can be assured that we have moved productively to meet the essential goal you set for us in 1974 -- the goal of ensuring that poor people, unable to afford an attorney, may nevertheless gain access to our system of justice when a civil legal need arises.

II. Status of LSC

It is with the goal of equal access to justice for the poor firmly in mind that the Corporation has developed its plans since its creation in 1975. We have been extremely successful in implementing those plans in a manner that diligently recognizes and respects the critical legal needs of our client community.

Our first objective was, as you know, the Minimum Access Plan. This plan was developed and refined in close consultation with this subcommittee and with our appropriations subcommittees in the House and the Senate. It was a plan designed to assure that low income persons in all parts of this country have available a minimal level of civil legal assistance. Minimum access was very conservatively defined as the equivalent of two attorneys for every 10,000 poor persons. You will recall that in 1975, legal services were simply unavailable in most parts of the country. In vast areas of the south, the southwest and the midwest, low income persons had no chance, no opportunity to see an attorney when a civil legal need arose. While there were more than 30 million persons found to be eligible for legal services in 1975, less than 1.3 million were living in areas where a minimal level of civil legal assistance (minimum access) was available.

In 1975, the newly established Legal Services Corporation set out to remedy that situation. Our Board and staff developed the minimum access plan, cognizant both of the vast unmet legal needs of the poor and the limited public funds available. We presented our plan to Congress and sought funding to implement it in a gradual and responsible manner. In five short years, this plan has been completed. We are extremely proud that today, legal services are being provided, at the minimum access level, in every part of this country.

The goal of equal access to justice has been the cornerstone of all Corporation plans in its short history. This is a program for and about clients and our current activities and future plans make that point abundantly clear.

The Legal Services Corporation has continually sought to maximize high quality civil legal assistance and minimize bureaucracy and overhead. Our funding allocations perhaps best display the strength of both our intentions and our results in this regard. Chart I indicates the allocation of Corporation funds for the 1981 fiscal year. Over 93% of our funds have been targeted for the direct provision of civil legal assistance to the poor. These funds go directly to legal services programs across the country so that hundreds and thousands of low income persons can be provided civil legal assistance when in need. We will describe these programs and the service they provide at a later point.

The chart also indicates the Corporation has made every effort to keep the bureaucracy of the program to a responsible minimum. Less than 1.6% of the annual budget is allocated for central management and administration purposes. The Corporation

is nevertheless well-managed within the constraints of its limited budget. We currently have 210 positions in our headquarters office in Washington, with another 97 positions located in our nine regional offices.

The management and administration responsibilities of the Corporation are critical to the effective operation of the program. We have other responsibilities, however, also directed to maximizing the delivery of high quality legal services directly to the poor.

Our regional offices are responsible for monitoring local programs on a regular basis. We have a substantial training program for lawyers, paralegals, support staff, as well as the managers of our local programs. Our research and experimentation are practical efforts to learn more about the needs of our clients and the most efficient and productive methods for meeting those needs. For example, we conducted a major study on the access difficulties and legal needs of several groups of low income individuals. This subcommittee is also familiar with our Delivery Systems Study which examined the utility of delivery systems supplemental and alternative to the traditional staff attorney approach. We are currently engaged in an effort to better define the standards of proficiency for legal services attorneys that will be a particularly useful contribution to the legal profession as a whole. We have undertaken a major effort to apply computer technology to legal services management and delivery, to increase program efficiency and maximize program resources.

All of our efforts are designed to ensure that the services provided to the poor are of the highest quality possible. The Legal Services Corporation is one small part of the overall program,

however, and it is critically important to understand the crucial role played by the local legal services programs across the country.

III. Status of Legal Services Programs

The Corporation currently funds 323 independent, locally controlled grantees providing essential legal services to the poor. These legal services programs are operating in 1,450 neighborhood offices throughout the 50 states, the District of Columbia, Puerto Rico, the Virgin Islands and Micronesia. Working in these programs around the country are over 6,200 attorneys and 2,800 paralegals earning salaries which are generally much lower than those of their counterparts in other public and private offices. The average lawyer or paralegal provides service to several hundred persons with legal problems in a year. Overall, by using the orderly dispute resolution mechanisms of our society, the Corporation's grantees improve the lives of millions of individuals throughout the Nation.

As mandated by Congress, each program is governed by a locally elected board, at least 60 percent of which consists of attorneys who are members of the bar of the State in which legal assistance is provided. At least one-third of the members are low income persons who are eligible for legal assistance. These local boards serve a crucial role in assuring that programs address the most serious legal problems in their communities and also that they develop service delivery approaches that best respond to local circumstances.

As a further assurance that legal services programs will direct their resources to the most pressing legal needs of clients, Congress also statutorily mandated that each program adopt

procedures for determining and implementing priorities for the provision of legal assistance. In setting their priorities for service, programs must look to the legal needs of eligible clients in their local communities. The priority-setting process is an opportunity for individuals living in the program's service area to voice their opinions as to the types of cases on which they believe the program should be concentrating their resources.

Thus, while Congress and the national and regional offices of the Corporation provide general guidance, technical assistance and oversight to local grantees, these programs are also directly controlled by and responsible to their own communities. As a result, legal services programs vary greatly, reflecting the nature of the client community they serve; the program serving Navajos over thousands of square miles of Arizona wilderness differs dramatically from the program charged with serving the inner city residents of Boston.

What all of the Corporation's grantees have in common, however, is their unflagging commitment to provide high quality services that respond to the actual needs of clients. Every program confronts mothers with small children who have been abandoned without support, elderly persons living alone in deplorable housing conditions, minimum wage earners with families whose income is garnisheed because of consumer fraud and questionable collection practices and children who are not being properly fed because of erroneous denials of public assistance benefits.

It is possible, from statistics collected by the Corporation, to develop a national picture of the types of legal problems being addressed by legal services programs as displayed in Chart II.

First of all, in 1980 LSC grantees provided representation to low income persons in over 1.2 million legal matters. The largest category of cases, representing approximately 30 percent of the total is designated "Family" which includes adoption, custody, divorce, support, parental rights, spouse abuse and other family-related matters. Income Maintenance and Housing are the next largest categories of legal problems, each representing between 17 and 18 percent of the total cases. Housing includes not just landlord/tenant disputes, but federally subsidized housing rights, home ownership, and other housing issues as well. Income maintenance runs the gamut of assistance programs including AFDC, Food Stamps, Social Security, SSI, veterans benefits, unemployment compensation, Black Lung benefits and others.

Looking at the rest of the pie chart, consumer issues make up almost 14 percent of all cases and cover contracts, warranties, credit, debt collection, and sales practices, as well as public utilities and energy related issues.

A grouping of education, juveniles, health, individual rights and employment cases constitute another 9.4 percent of the pie chart, with the final 11.7 percent being made-up of such miscellaneous issues as torts, wills, auto licenses, incorporation matters and others.

One overarching fact which is, perhaps, lost in any detailing of case statistics is the fact that the need for legal services far exceeds existing program capacity. Virtually every program is forced to turn clients away and to make difficult choices between competing needs of financially eligible individuals. Therefore, it is important to remember that these statistics

represent only the present ability of programs to serve clients, not the full extent of the needs of low-income persons for legal assistance.

As I mentioned previously, local program boards help to determine the priority legal needs to be addressed, as well as the most appropriate service delivery model that best responds to local circumstances. Their experience has demonstrated that the staff attorney component is essential to the provision of the full range and quality of services required by clients. That has been confirmed by evidence from the Delivery Systems Study as well. However, the Corporation and programs have found that improvements in service can be made through additional private attorney involvement in the delivery of legal assistance. This is most efficiently carried out through the existing system of grantee programs; duplication of administrative costs are avoided and the grantees perform the necessary screening and referral functions that match the needs of clients with the delivery system best able to address them. Many grantees have successfully incorporated private attorneys in their delivery mechanism; in 1980, 96 programs included an organized pro bono effort in their service delivery; 64 programs contracted with private attorneys or law firms for additional services to clients; and 7 grantees operated a supplemental judicare component. Initial data gathered for 1981 indicates that grantees are utilizing private bar assistance to an even greater degree this year. These figures are, of course, in addition to the independent judicare programs funded directly by the Corporation.

IV. Legal Services Clients

The Legal Services Corporation and all of its programs are dedicated to serving the interests of their low income clients. It is the clients who are the heart and soul of the program, and we would be remiss if we failed to convey the importance of legal services to their lives.

Programs funded by the Legal Services Corporation served more than 1.2 million clients in 1980. Chart III provides some very basic information about ethnic and age distribution about those clients. You know as well that all are persons with incomes at or below 125% of the official OMB poverty threshold. That means for example, that legal services is only available for a person earning less than \$4,738 a year -- or a family of four earning less than \$9,313 a year. An income of under \$10,000 per year does not allow payment for the services of a private attorney. We cannot fail to recognize that a person or family with such an income would simply be denied any access to our system of justice were federally funded legal services for the poor unavailable.

The statistics hide the human crises that bring these people to legal services offices -- children pushed into programs for the mentally retarded without any evaluation of their mental abilities, mothers with no money to feed their families for the next three weeks, elderly persons whose heat has been cut off because their landlords did not pay the utility bill.

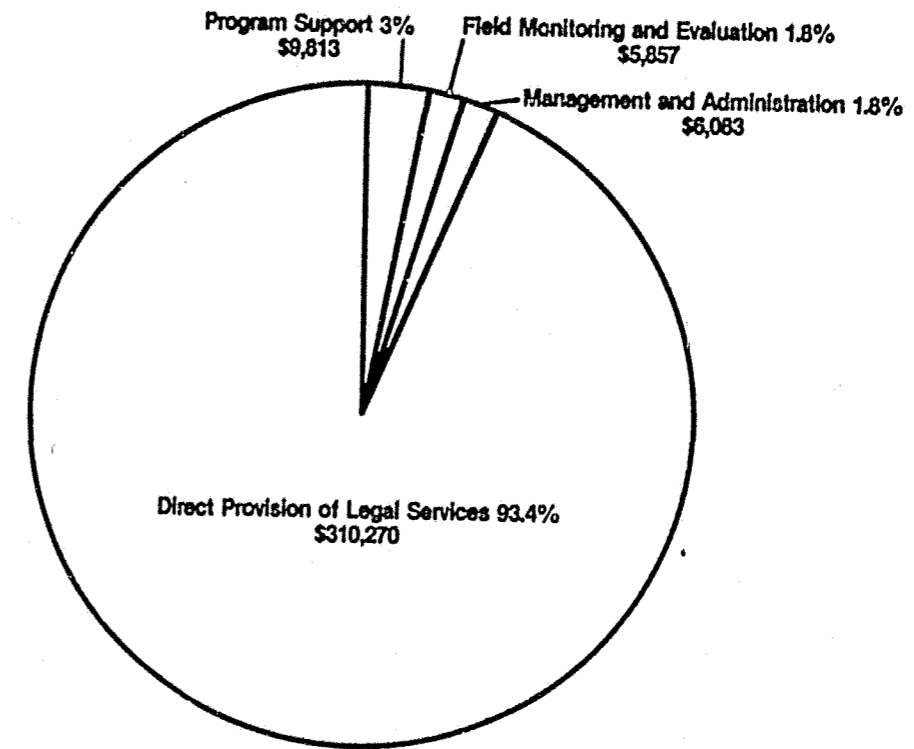
In the next month, you will be hearing testimony from some of those clients and from the lawyers who represent them. I hope that each member of this Committee will take the time to look closely at the legal services programs in your own Congressional

district -- to discuss with the lawyers and paralegals in your communities the day to day work they do -- to talk to your own low-income constituents about the problems they bring to your legal services programs. That is the critical information that will help in the consideration of the legislative issues you will be addressing over the next few months -- much more so than anything I can report to you today.

I am pleased to present this background information and will be happy to respond to any questions you may have.

Chart I

**LEGAL SERVICES CORPORATION
1981 DISTRIBUTION OF RESOURCES**
(DOLLARS IN THOUSANDS)



Includes all sources of funds: 1981 appropriations, balances brought forward from 1980, investment income, donated services, miscellaneous receipts.

Chart II

DISTRIBUTION OF CASES CLOSED BY PROBLEM

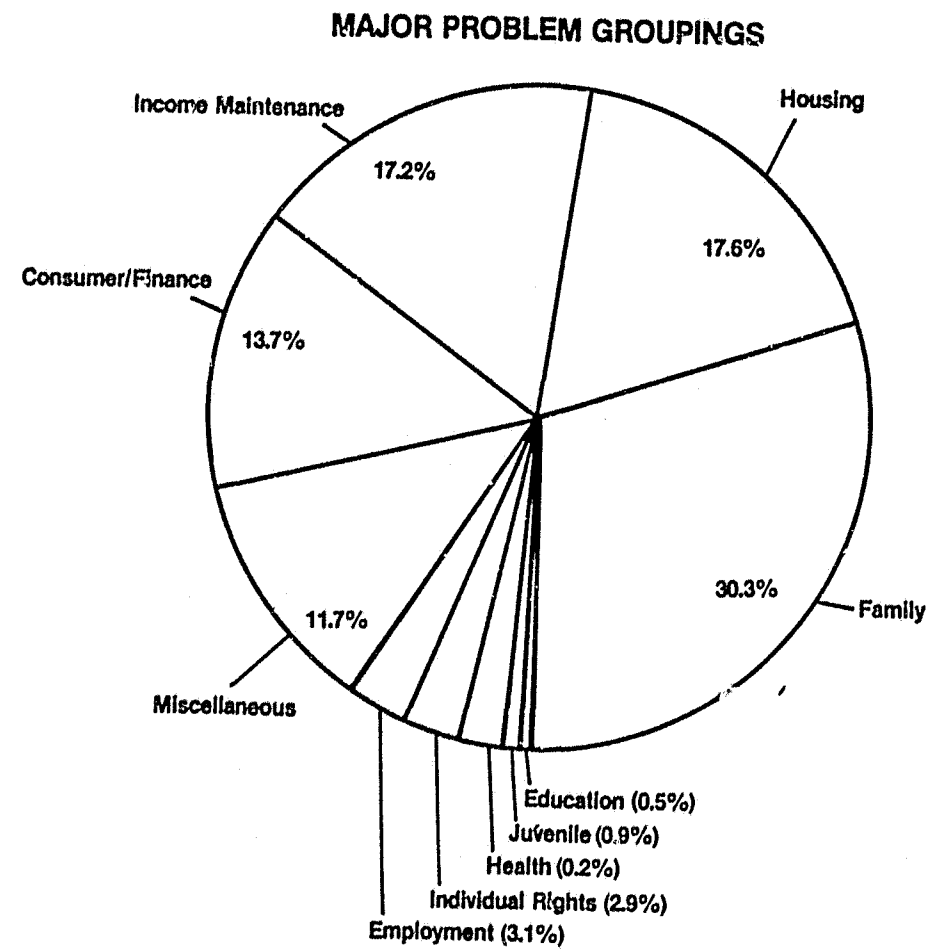
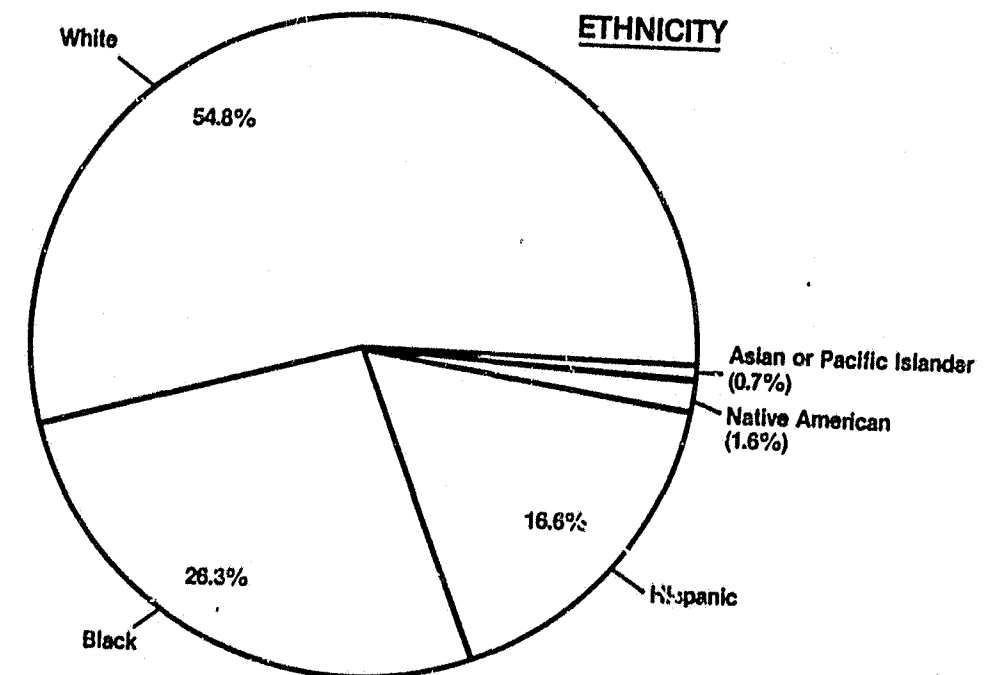
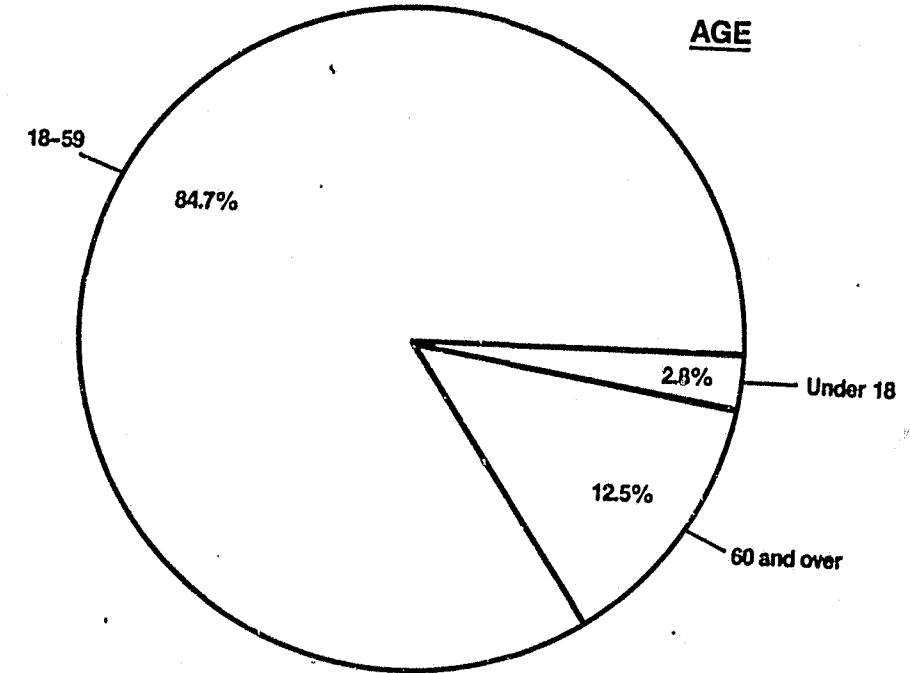


Chart III

DISTRIBUTION OF CLIENT CHARACTERISTICS



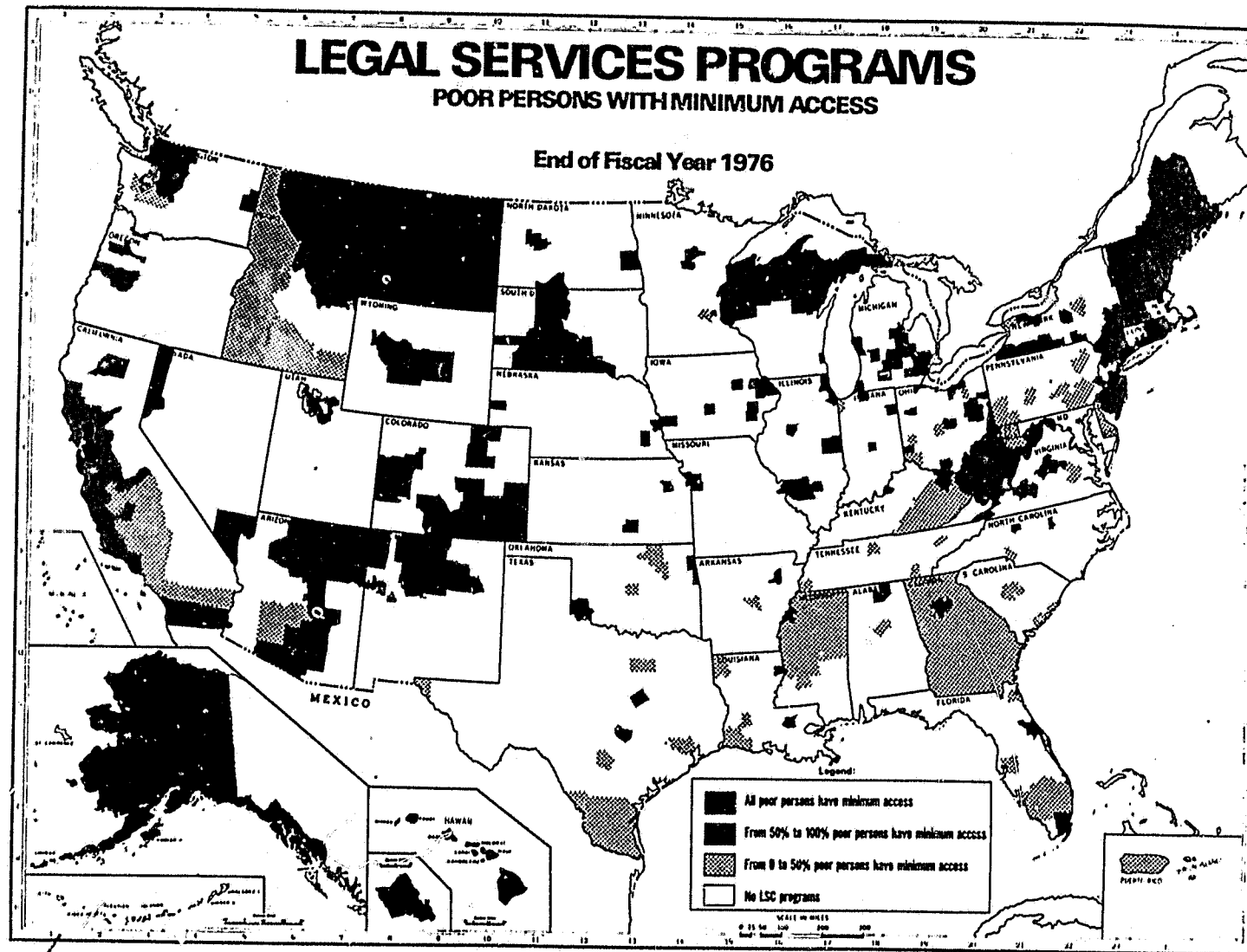
REPORTS OF THE LEGAL SERVICES CORPORATION

Delivery Systems Study -- A Research Project on the Delivery of
of Legal Services to the Poor (A Report to the President and
the Congress of the United States As Required by the Legal
Services Corporation Act of 1974 Section 1007(g) - July 1977

Delivery Systems Study -- A Policy Report to the Congress and the
President of the United States - June 1980

Special Legal Problems and Problems of Access to Legal Services
of Veterans, Native Americans, People with Limited English-
Speaking Abilities, Migrant and Seasonal Farm Workers and
Individuals in Sparsely Populated Areas (A Report to Congress As
Required by Section 1007(h) of the Legal Services Corporation
Act of 1974, As Amended) Volumes 1 and 2 and Summary - 1979

Special Difficulties of Access and Special Unmet Legal Problems
of the Elderly and Handicapped - Summary (A Continuation of a
Report to Congress Required by Section 1007(h) of the Legal
Services Corporation Act of 1974, As Amended - May 1980



CHARACTERISTICS OF FIELD PROGRAMS
SUPPORTED BY THE LEGAL SERVICES CORPORATION
START OF 1981 - A FACT BOOK

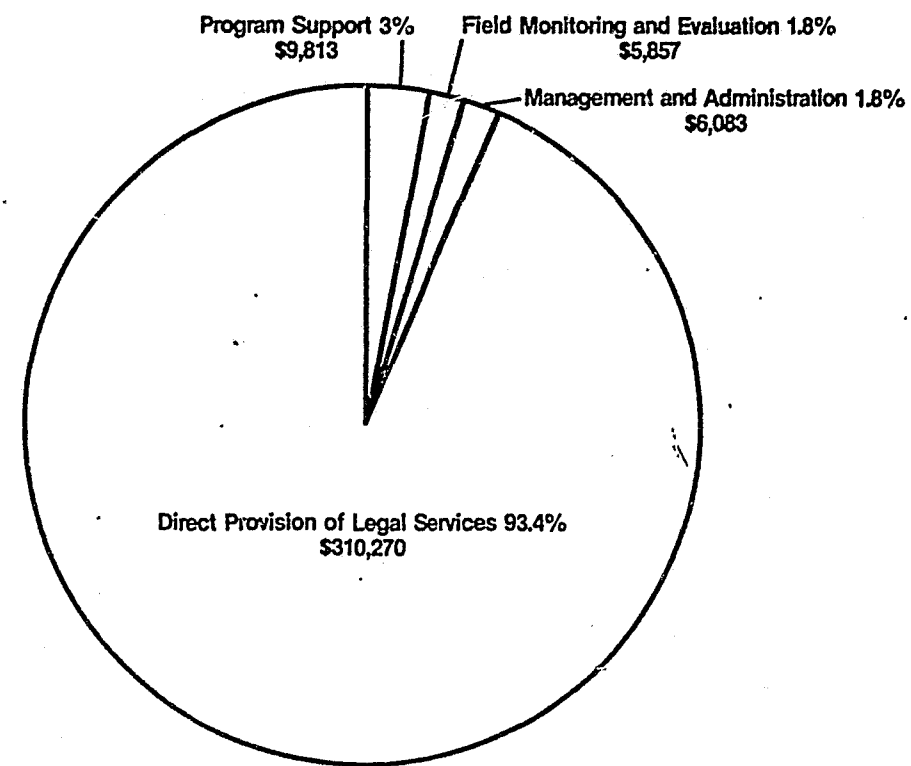
LEGAL SERVICES CORPORATION

Data contained in the following graphs and tables were extracted from information submitted by Legal Services Corporation supported field programs in their 1981 grant applications. Grant applications for the 1981 program year were received in October - November, 1980; generally, the data reflect the status of programs as of January, 1981.

The following tables and graphs are not based on data from all Legal Services Corporation supported programs. National Support Programs were excluded due to differences in staffing and budgeting patterns. In addition, a few field programs were omitted because data had not been submitted at the time the graphs and tables were prepared.

The FACT BOOK is a product of the Information Unit of the Office of Field Services.

**LEGAL SERVICES CORPORATION
1981 DISTRIBUTION OF RESOURCES**
(DOLLARS IN THOUSANDS)



Includes all sources of funds: 1981 appropriations, balances brought forward from 1980, investment income, donated services, miscellaneous receipts.

NUMBER OF PROGRAMS SUPPORTED BY THE LEGAL SERVICES CORPORATION

At the beginning of 1981, there were 323 legal services programs throughout the 50 states, the District of Columbia, the Virgin Islands, Puerto Rico, Micronesia and Guam.

The 323 Legal Services programs include:

- 290 Basic Field Programs (including 29 Migrant Components and 20 Native American Components)
- 3 Migrant Programs
- 8 Native American Programs
- 5 State Support Programs
- 17 National Support Centers

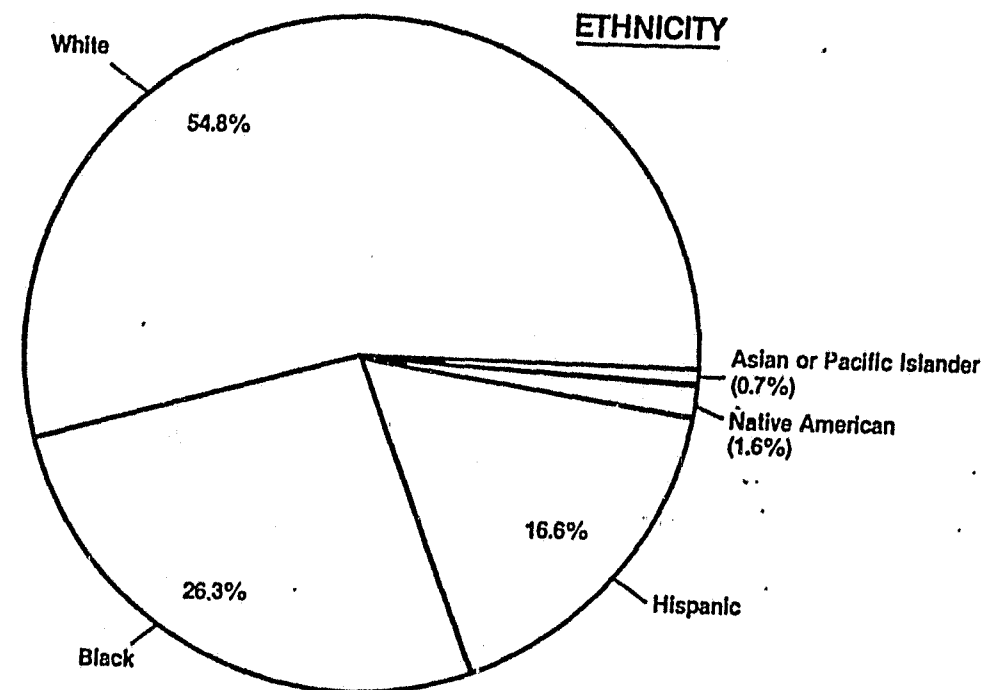
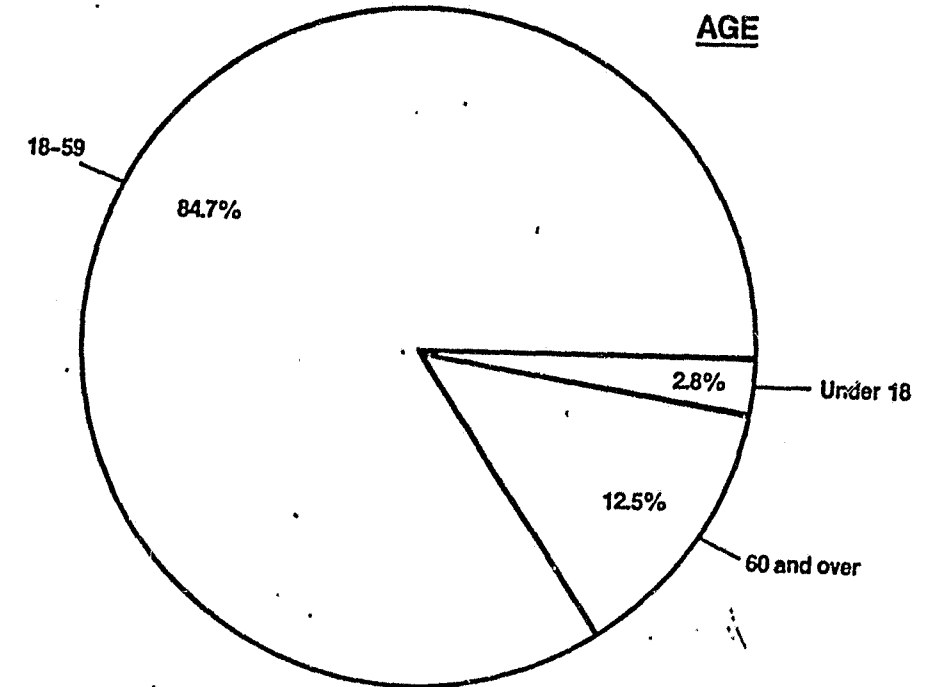
LEGAL SERVICES CORPORATION
FIELD PROGRAM ANNUALIZED FUNDING LEVELS BY STATE, FY 1981^{a/}

State	Basic Field ^{b/}	Migrant	Native American	Total
Alabama	\$ 7,145,723	\$ 36,028	\$ 0	\$ 7,181,751
Alaska	1,244,992	0	290,096	1,535,088
Arizona	2,218,284	245,920	2,300,446	4,764,650
Arkansas	4,157,887	0	0	4,157,887
California	24,501,472	1,175,809	668,666	26,345,947
Colorado	2,707,430	162,783	20,515	2,890,728
Connecticut	2,805,426	54,041	0	2,859,467
Delaware	506,708	0	0	506,708
District of Columbia	2,998,420	0	0	2,998,420
Florida	8,989,789	712,674	0	9,702,463
Georgia	7,955,397	275,598	0	8,230,995
Hawaii	770,478	0	0	770,478
Idaho	814,150	182,193	46,701	1,043,044
Illinois	9,366,656	218,152	0	9,584,808
Indiana	4,249,514	107,107	0	4,356,621
Iowa	3,086,479	0	0	3,086,479
Kansas	2,340,785	51,584	0	2,392,369
Kentucky	6,136,948	0	0	6,136,948
Louisiana	7,747,126	71,236	0	7,818,362
Maine	1,177,780	152,380	3,932	1,334,092
Maryland	3,202,067	89,038	0	3,291,105
Massachusetts	6,513,147	0	0	6,513,147
Michigan	7,351,402	403,444	0	7,754,846
Minnesota	3,493,440	291,916	167,787	3,953,143
Mississippi	6,479,727	0	31,928	6,511,655
Missouri	5,589,466	0	0	5,589,466
Montana	854,572	99,076	95,878	1,049,526
Nebraska	1,727,266	0	23,761	1,751,027
Nevada	389,804	0	0	389,804
New Hampshire	776,434	0	0	776,434
New Jersey	5,724,181	147,386	0	5,871,567
New Mexico	1,920,604	67,752	333,262	2,321,618
New York	19,471,899	213,449	0	19,685,348
North Carolina	7,955,447	246,400	47,093	8,248,940
North Dakota	848,367	0	137,063	985,430
Ohio	8,895,510	252,099	0	9,147,609
Oklahoma	3,875,402	78,605	260,825	4,214,832
Oregon	2,405,030	262,133	40,631	2,707,794
Pennsylvania	10,254,997	0	0	10,254,997
Rhode Island	897,873	0	0	897,873
South Carolina	4,988,855	99,076	0	5,087,931
South Dakota	1,007,637	0	663,177	1,670,814
Tennessee	7,107,844	0	0	7,107,844
Texas	17,149,149	1,546,657	0	18,695,806
Utah	1,012,424	36,028	14,598	1,063,050
Vermont	688,862	0	0	688,862
Virginia	5,702,151	64,080	0	5,766,231
Washington	3,537,206	406,948	168,014	4,112,168
West Virginia	3,163,398	0	0	3,163,398
Wisconsin	3,673,375	100,632	96,475	3,870,482
Wyoming	406,844	41,759	121,218	569,821
Micronesia	944,820	0	0	944,820
Puerto Rico	14,392,869	359,091	0	14,751,960
Virgin Islands	501,934	0	0	501,934
Guam	199,257	0	0	199,257
Total	\$264,024,704	\$8,251,074	\$5,532,066	\$277,807,844

^{a/}This table represents annualized funding levels in FY 1981, including the annualized cost of service increase. Excluded are: national support funds; non-annualized funds and other funds not yet committed in 1981 to specific states.

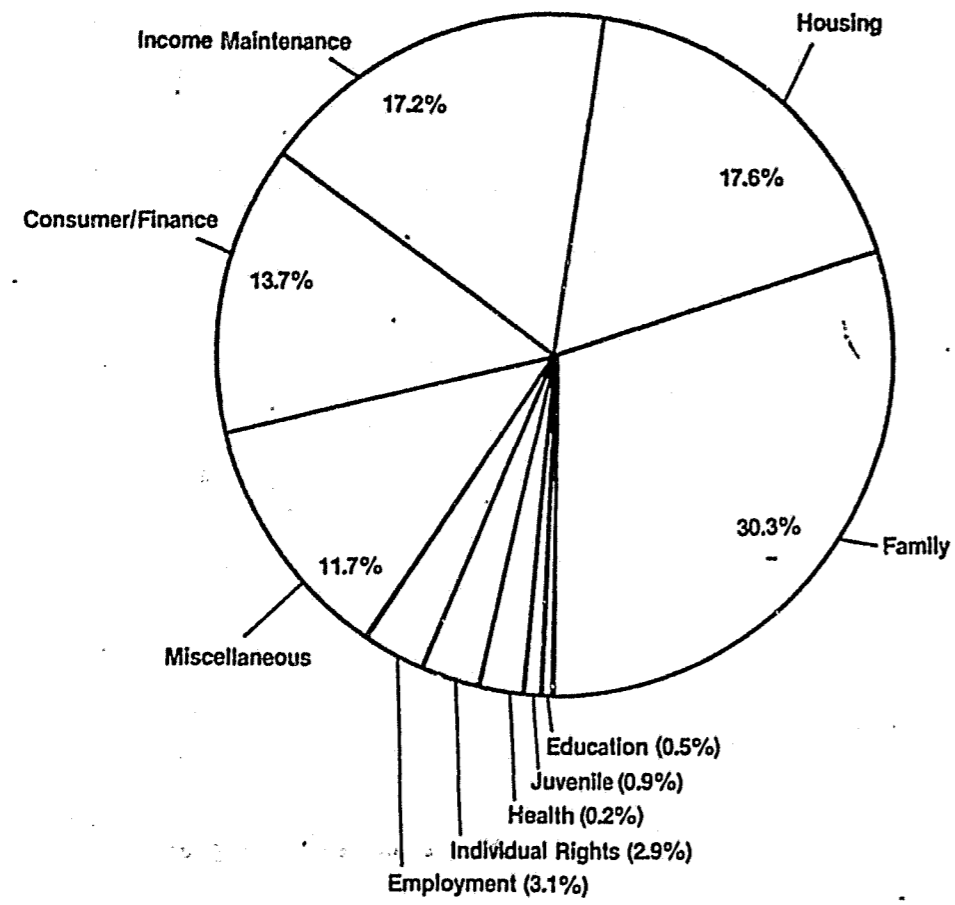
^{b/}Includes funding for state support activities awarded prior to February 1981.

DISTRIBUTION OF CLIENT CHARACTERISTICS

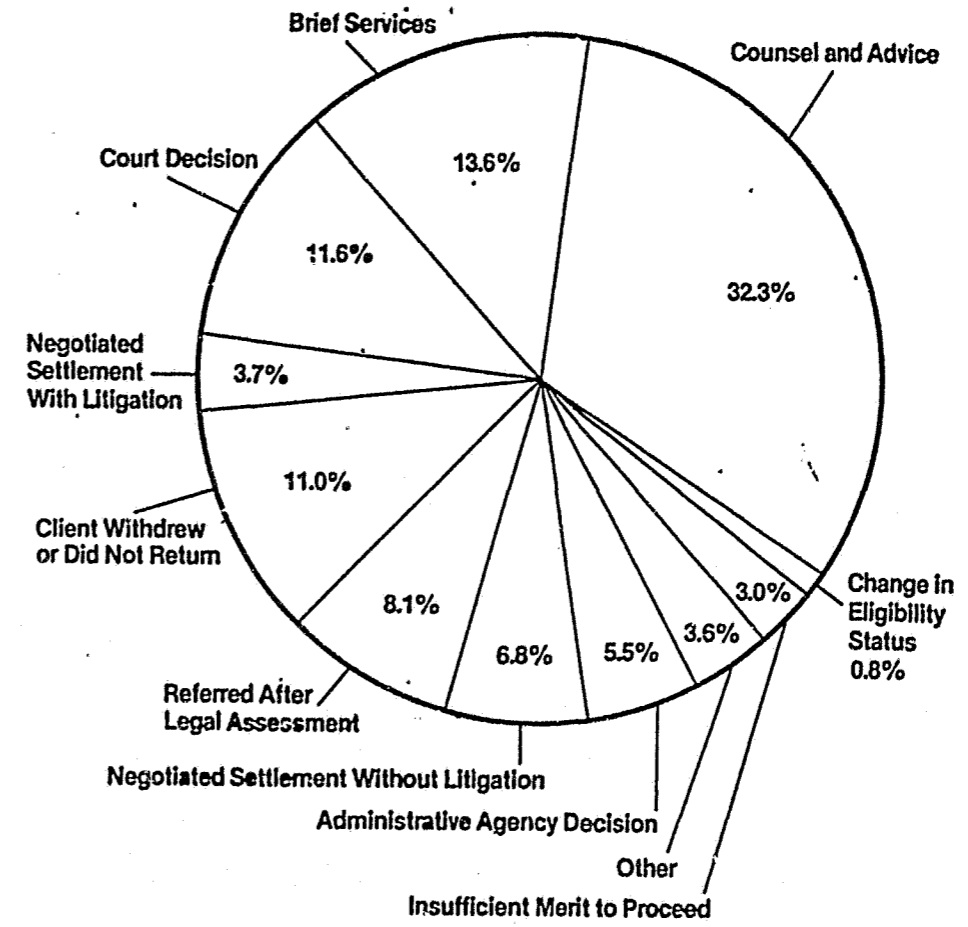


DISTRIBUTION OF CASES CLOSED BY PROBLEM

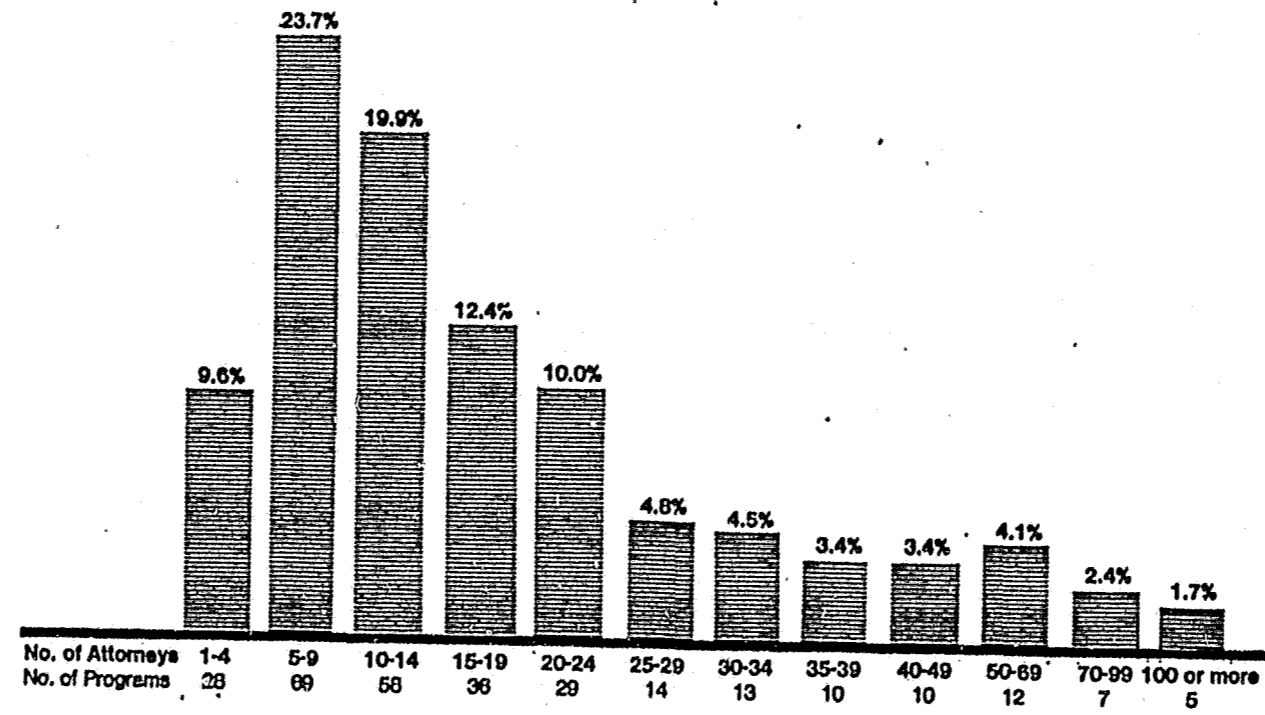
MAJOR PROBLEM GROUPINGS



DISTRIBUTION OF CASES CLOSED BY REASON



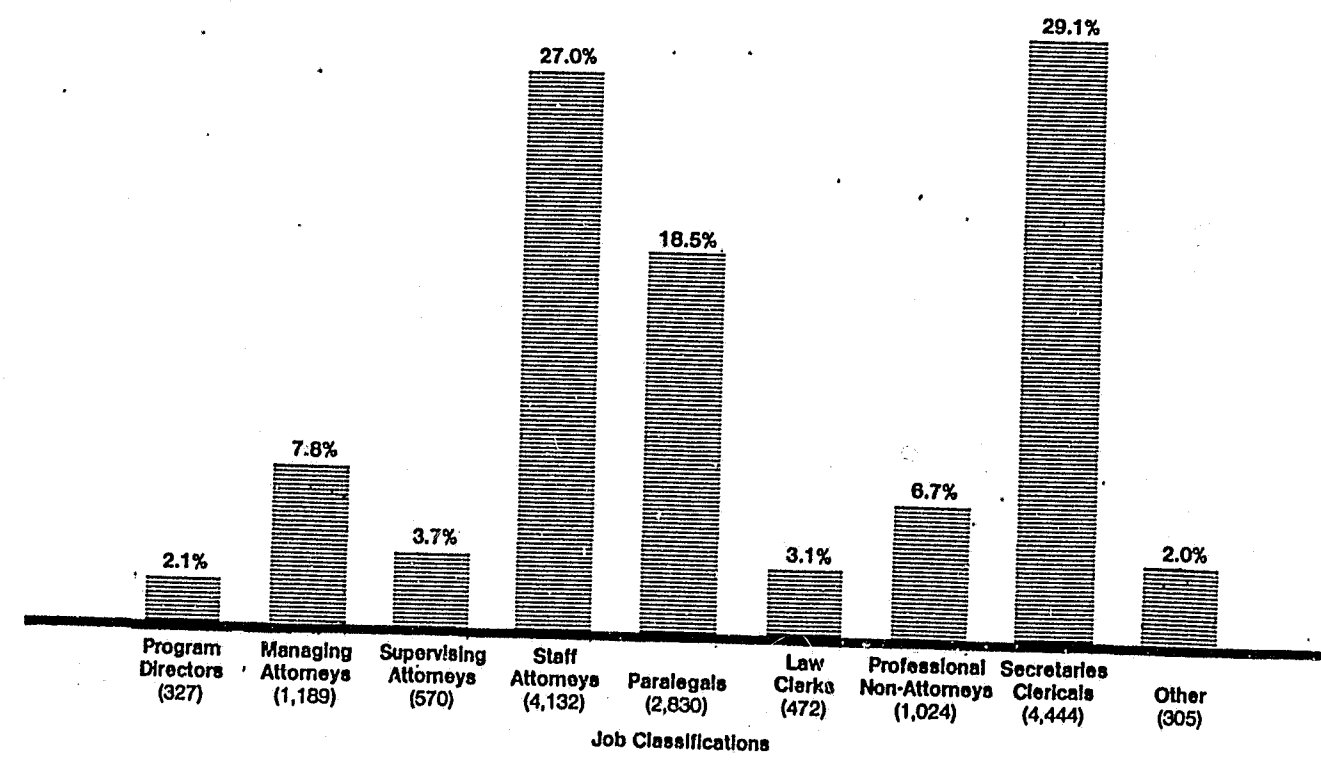
DISTRIBUTION OF PROGRAMS BY NUMBER OF ATTORNEYS
START OF 1981



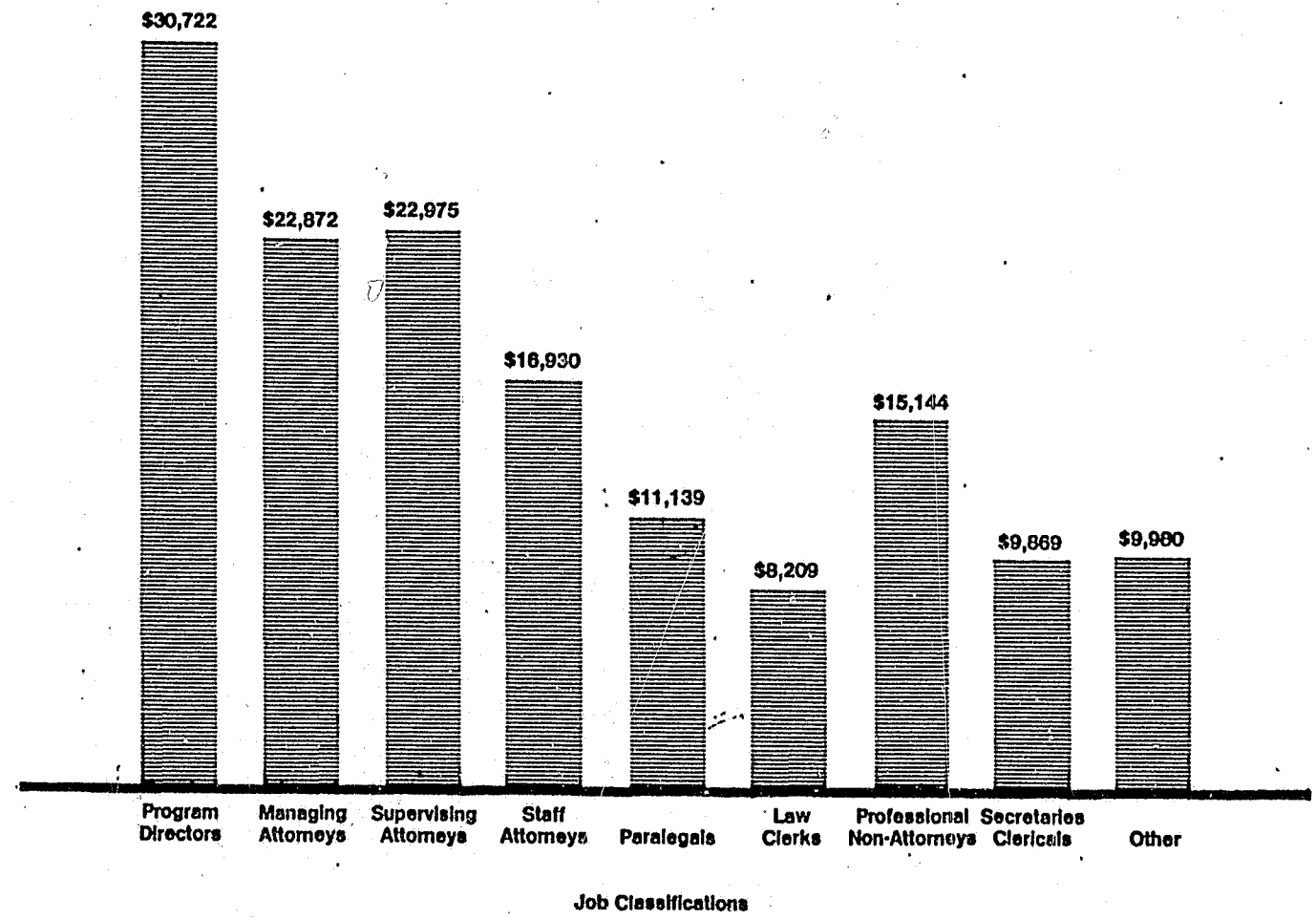
FIELD PROGRAM EMPLOYEES' BY JOB CLASSIFICATION
START OF 1981

Job Classification	Number of Employees	Percent
Program Directors	327	2.1
Managing Attorneys	1,189	7.8
Supervising Attorneys	570	3.7
Staff Attorneys	4,132	27.0
Paralegals	2,830	18.5
Law Clerks	472	3.1
Professional Non-Attorneys	1,024	6.7
Secretarial/Clerical	4,444	29.1
Other	305	2.0
Total	15,293	100.0

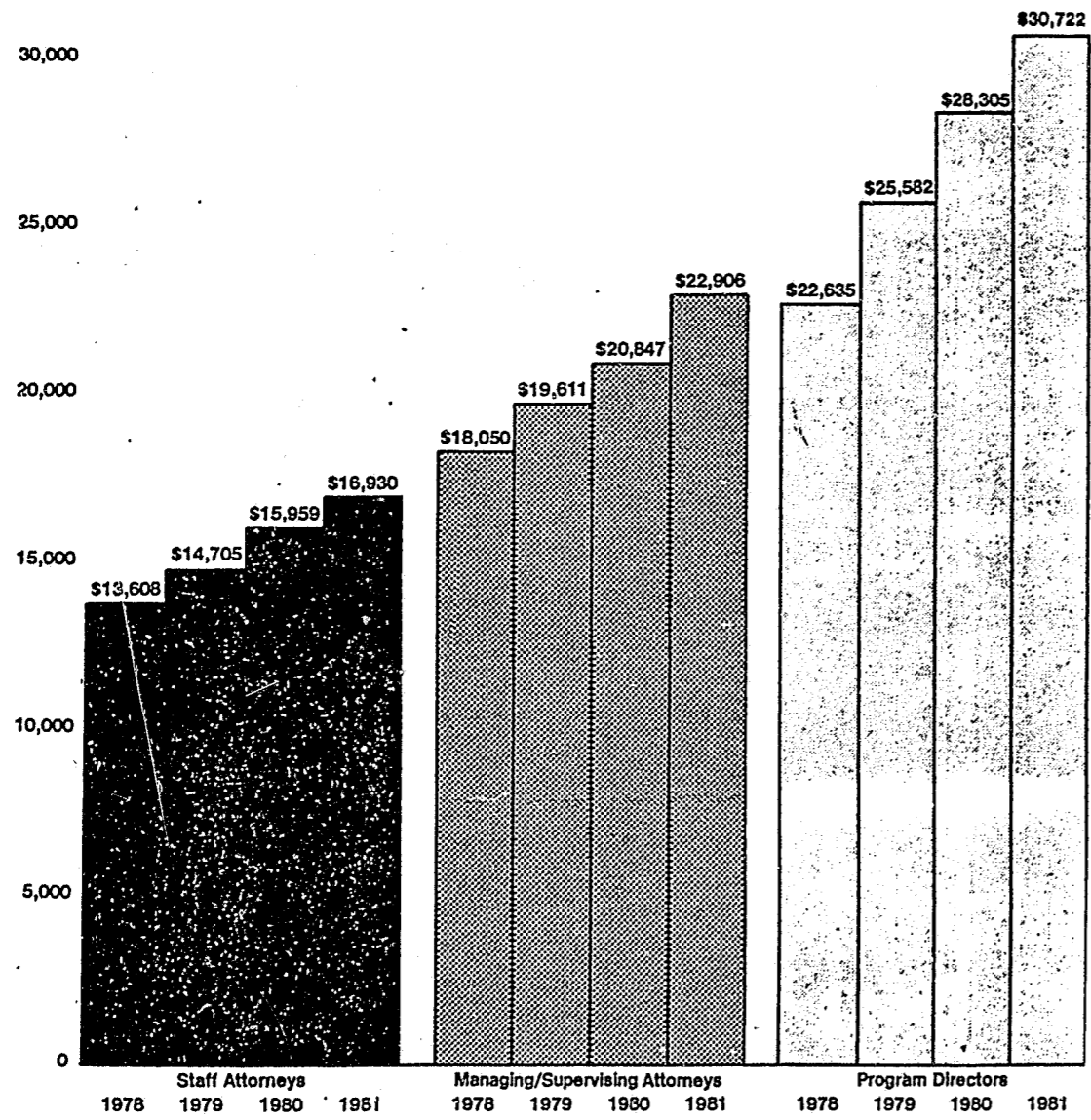
PERCENT OF ALL FIELD PROGRAM EMPLOYEES WITHIN EACH JOB CLASSIFICATION
START OF 1981



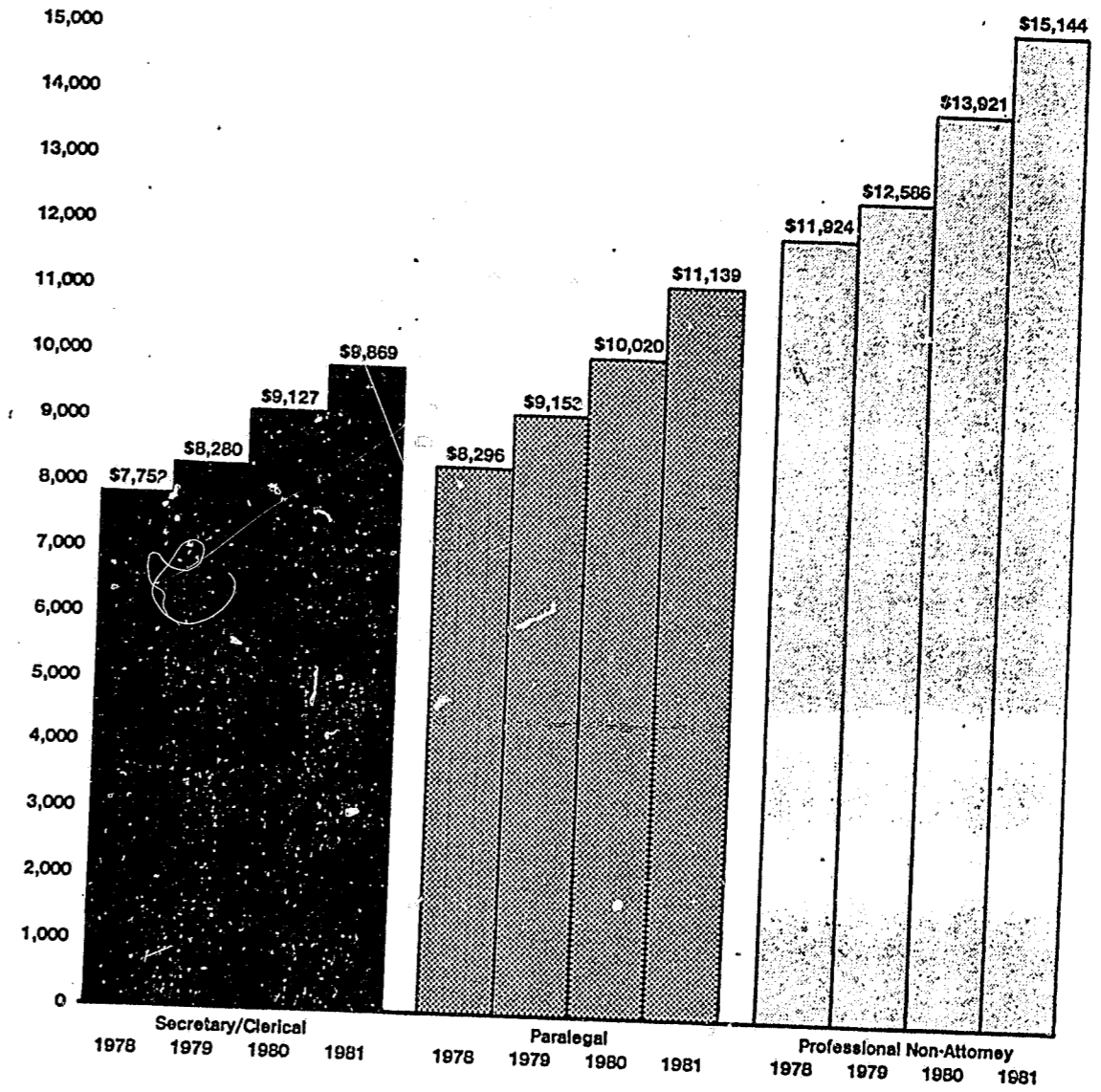
AVERAGE SALARIES OF FIELD PROGRAM EMPLOYEES BY JOB CLASSIFICATION
START OF 1981



AVERAGE ATTORNEY SALARIES BY JOB CLASSIFICATION
START OF 1978, 1979, 1980, 1981



AVERAGE NON-ATTORNEY SALARIES BY JOB CLASSIFICATION
START OF 1978, 1979, 1980, 1981

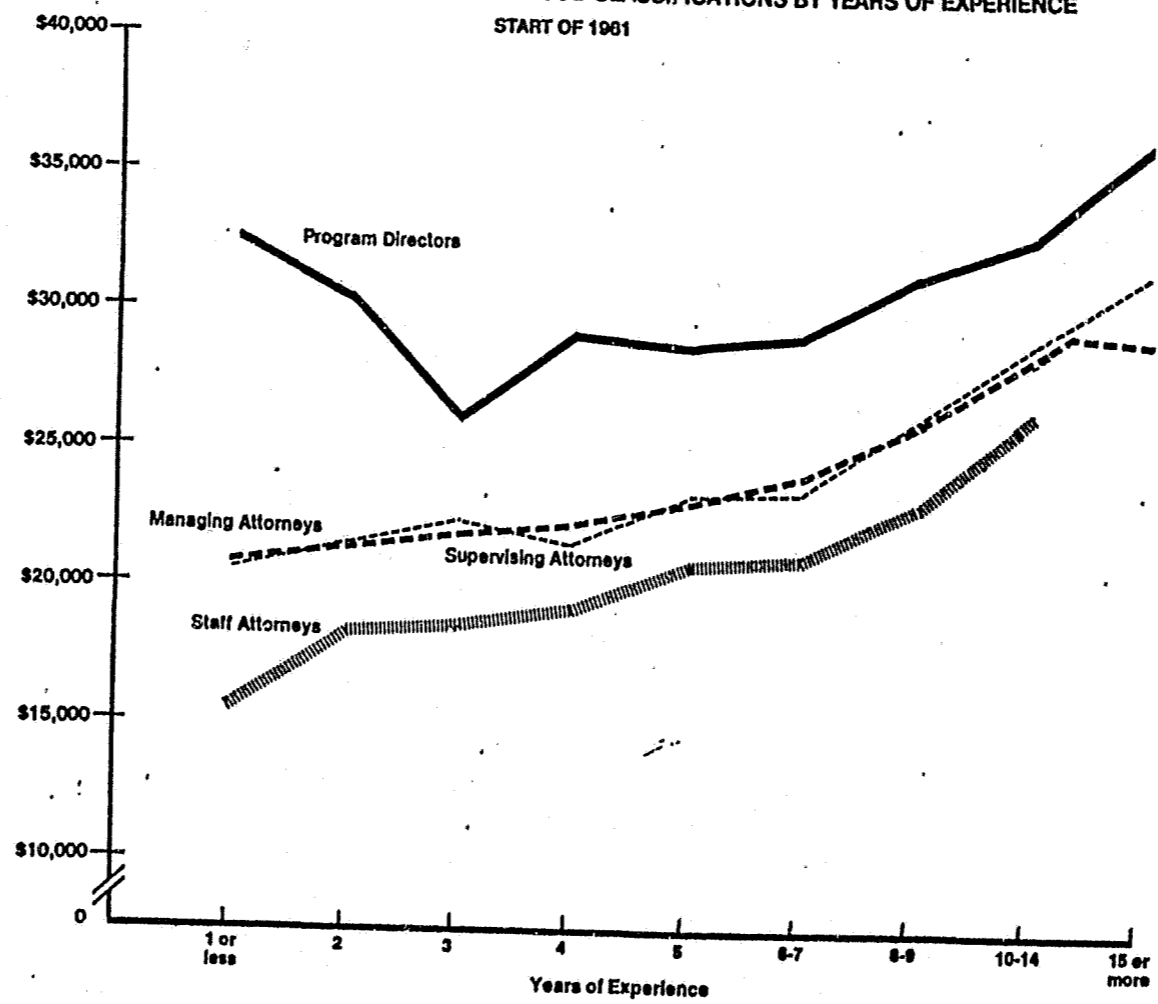


AVERAGE SALARY LEVELS WITHIN ATTORNEY JOB CLASSIFICATIONS
BY YEARS OF EXPERIENCE, START OF 1981

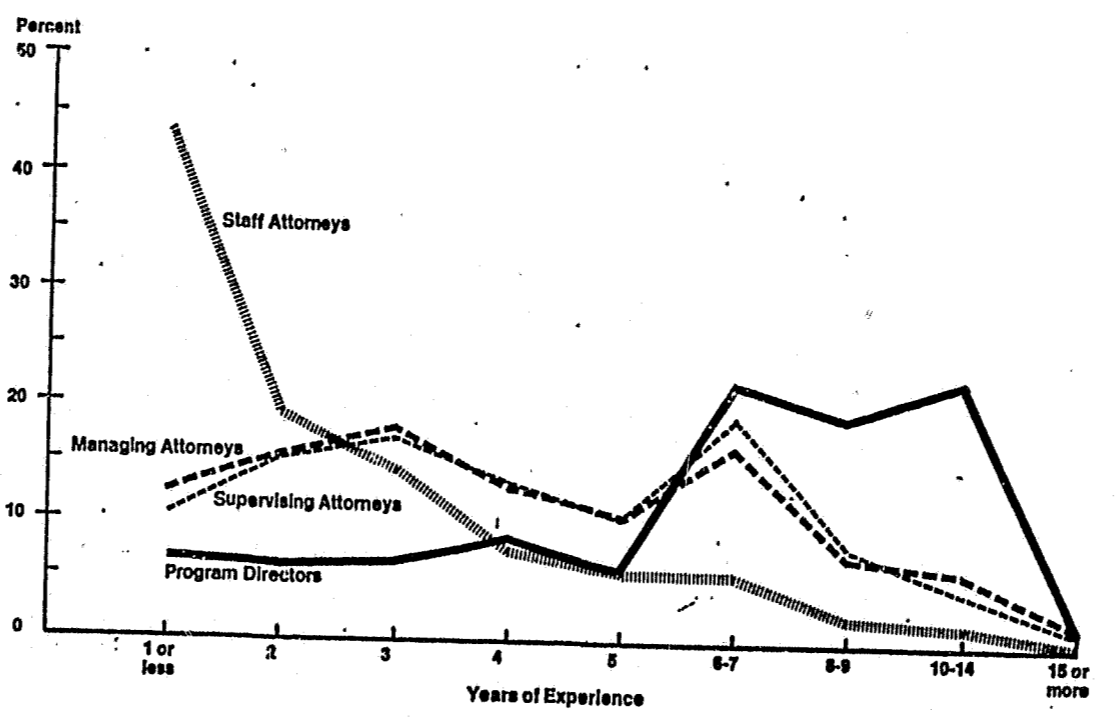
	Years of Experience	Average Annual Salary	Number of Attorneys	Percent ^{a/}	
PROGRAM DIRECTORS	1 year or less	\$ 32,601	21	6.7	
	2 years	30,538	20	6.3	
	3 years	26,477	21	6.7	
	4 years	29,343	28	8.9	
	5 years	28,100	18	5.7	
	6-7 years	29,790	70	22.2	
	8-9 years	31,144	61	19.4	
	10-14 years	33,727	71	22.5	
	15 years and above	36,934	5	1.6	
	Total			315	100.0
		Vacant/Unreported		13	
MANAGING ATTORNEYS	1 year or less	20,939	134	12.4	
	2 years	21,299	171	15.8	
	3 years	22,082	194	17.9	
	4 years	22,489	136	12.5	
	5 years	23,078	116	10.7	
	6-7 years	24,438	178	16.4	
	8-9 years	27,326	79	7.3	
	10-14 years	29,512	71	6.5	
	15 years and above	28,777	6	0.5	
	Total			1,085	100.0
		Vacant/Unreported		105	
SUPERVISING ATTORNEYS	1 year or less	20,799	56	10.5	
	2 years	21,446	83	15.6	
	3 years	21,326	90	16.9	
	4 years	21,580	72	13.5	
	5 years	22,526	56	10.5	
	6-7 years	24,916	102	19.1	
	8-9 years	27,402	44	8.3	
	10-14 years	29,575	23	4.3	
	15 years and above	31,903	7	1.3	
	Total			533	100.0
		Vacant/Unreported		45	
STAFF ATTORNEYS	1 year or less	15,861	1,644	43.6	
	2 years	17,181	737	19.6	
	3 years	17,987	550	14.6	
	4 years	19,070	284	7.5	
	5 years	21,136	215	5.7	
	6-7 years	22,272	211	5.6	
	8-9 years	23,859	71	1.9	
	10-14 years	27,786	56	1.5	
	15 years and above	--	1	0.0	
	Total			3,769	100.0
		Vacant/Unreported		389	

^{a/} Percentages are based on the number of attorneys for whom both experience and salary data were reported in the 1981 grant applications.

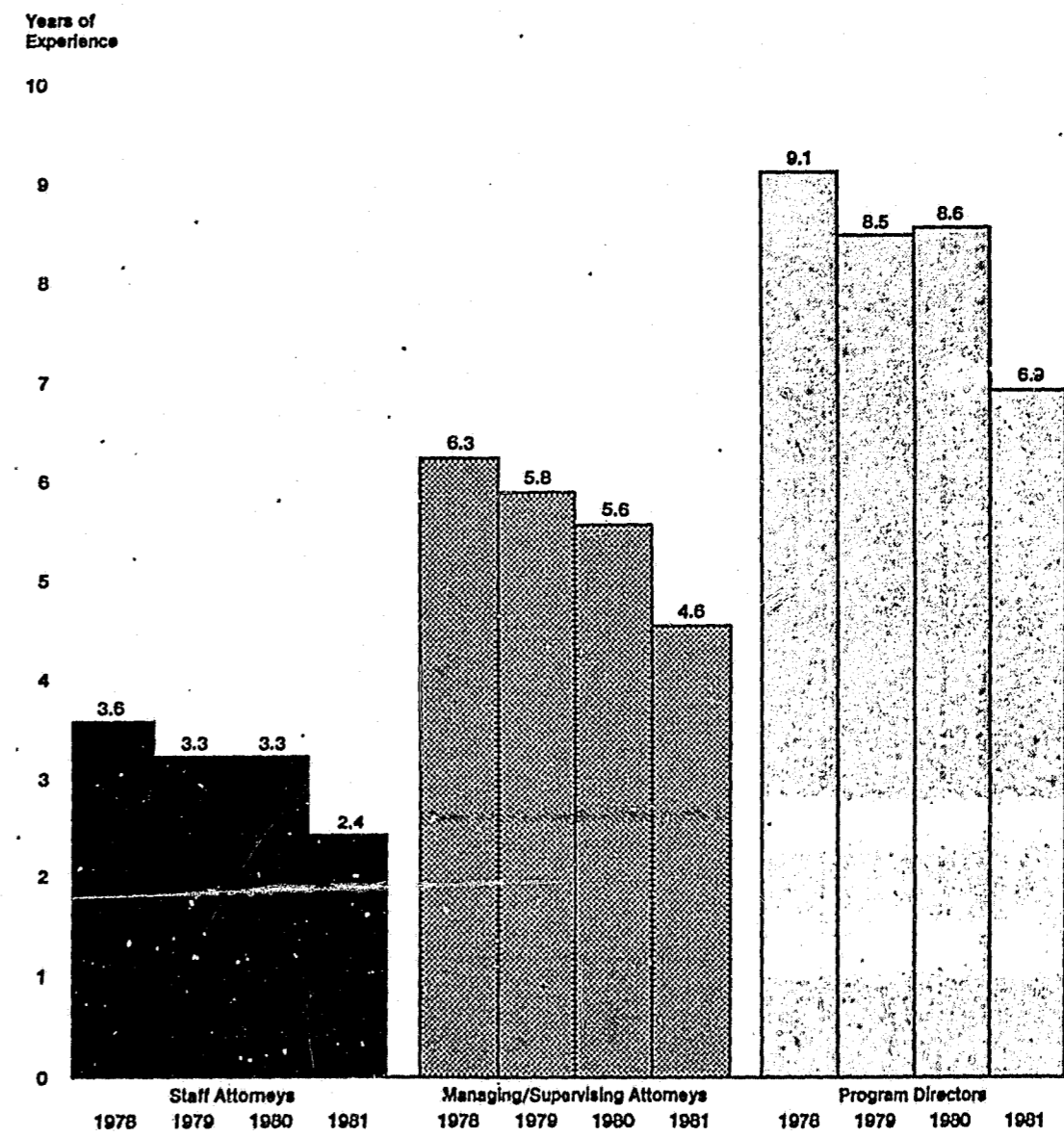
AVERAGE SALARY LEVELS WITHIN ATTORNEY JOB CLASSIFICATIONS BY YEARS OF EXPERIENCE
START OF 1981



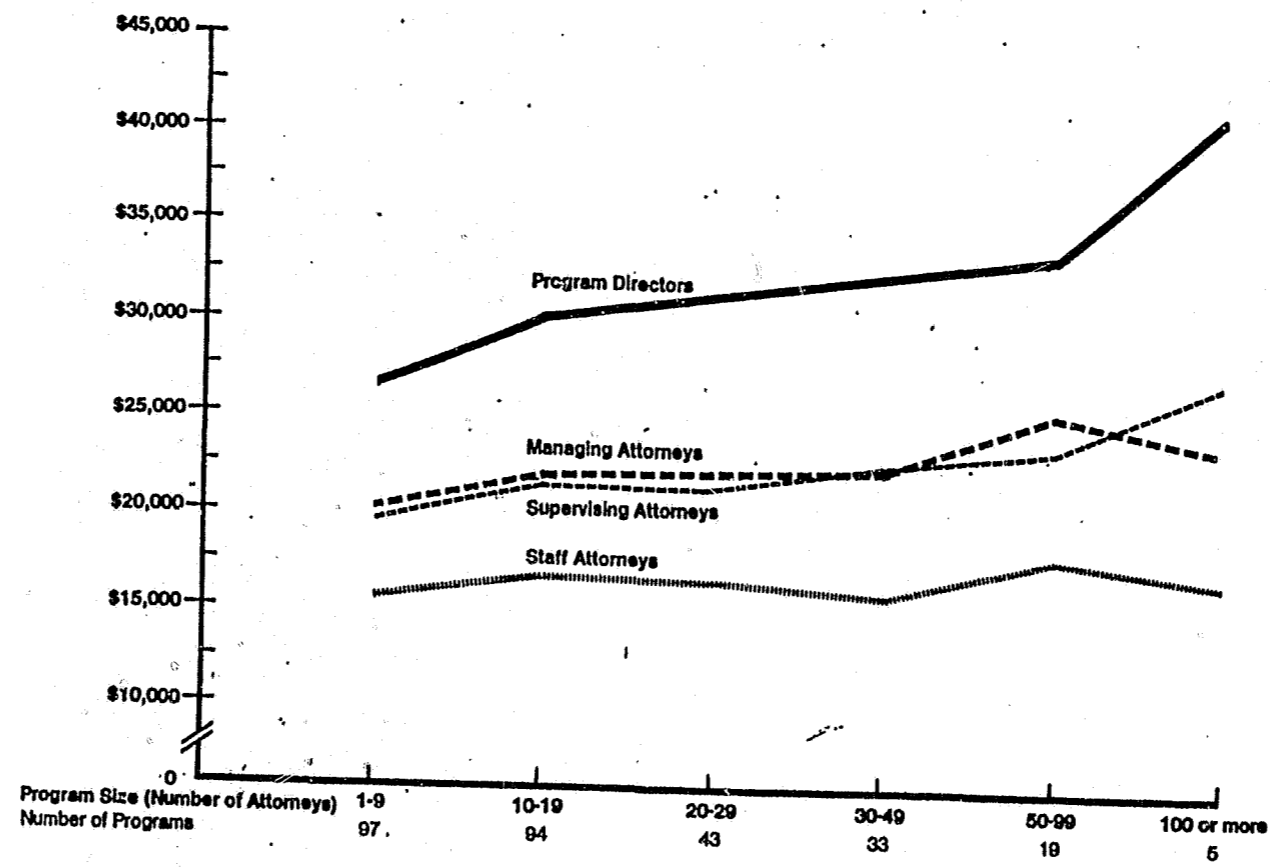
PERCENT OF ATTORNEYS WITHIN JOB CLASSIFICATIONS AT VARYING LEVELS OF EXPERIENCE
START OF 1981



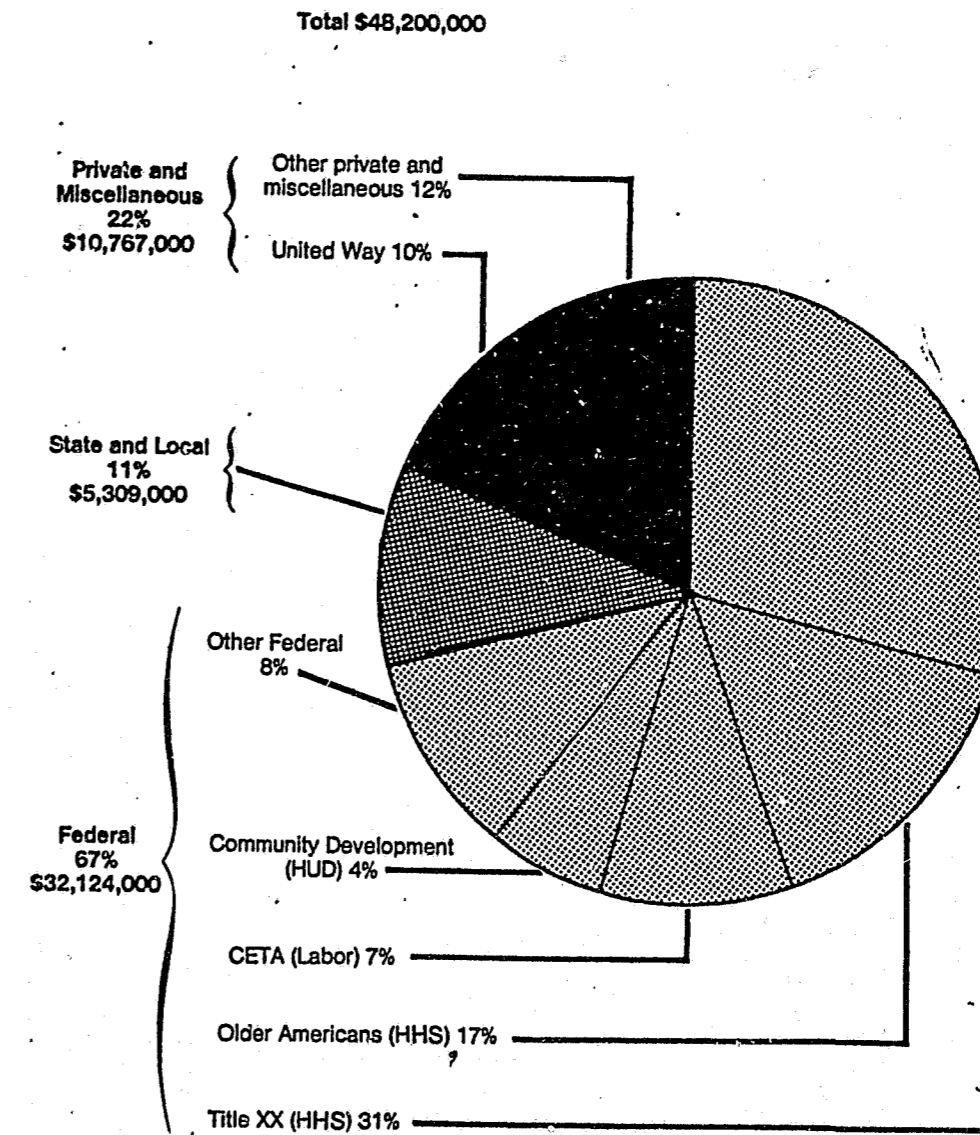
AVERAGE YEARS OF EXPERIENCE OF ATTORNEYS BY JOB CLASSIFICATION
START OF 1978, 1979, 1980, 1981



AVERAGE ATTORNEY SALARIES IN PROGRAMS OF VARYING SIZES BY JOB CLASSIFICATION
 START OF 1981



**ESTIMATED DISTRIBUTION OF NON-CORPORATION FUNDS
BY SOURCE IN 1981**



DISTRIBUTION OF FUNDING AND PROGRAMS BY PERCENT OF NON-LEGAL SERVICES
CORPORATION FUNDS IN PROGRAMS' TOTAL BUDGETS, START OF 1981

Percent of Total Budget from Non-LSC Sources	Number and Percent of Field Programs		Amount of Non-LSC Funds	Percent of all Non-LSC Funds	Amount of LSC Field Funds ^{a/}	Percent of all LSC Field Funds
Zero %	52	17.9 %	\$. 0	0.0	\$ 51,148,288	20.2 %
1 - 10	88	30.2	5,294,614	11.0	103,460,832	40.8
11 - 20	52	17.9	7,111,597	14.8	39,041,264	15.4
21 - 30	49	16.8	11,280,382	23.4	33,404,544	13.2
31 - 40	13	4.5	4,346,624	9.0	7,564,558	2.8
41 - 50	19	6.5	8,498,895	17.7	10,027,487	3.9
51 - 60	10	3.4	8,579,198	17.8	7,492,559	3.0
61 - 70	8	2.7	3,032,193	6.3	1,680,244	0.7
71% or more	0	0.0	0	0.0	0	0.0
TOTAL	291	100.0 %	\$48,143,503	100.0 %	\$253,819,776	100.0 %

^{a/} This column represents annualized field program funds. It was calculated by adding the 6% annualized "Cost of Service Adjustment" to each field programs' FY 1980 annualized base funding.

LEGAL SERVICES CORPORATION

FIELD PROGRAM ALLOCATIONS OF CORPORATION AND NON-CORPORATION FUNDS BY BUDGET CATEGORIES^{1/}

FISCAL YEARS 1980 AND 1981^{2/}
(Dollars in Thousands)

	FISCAL YEAR 1980 (Estimated)		FISCAL YEAR 1981 (Estimated)	
	Dollars	Percent	Dollars	Percent
TOTAL FIELD PROGRAM ALLOCATIONS	\$331,922	100.0	\$359,530	100.0
Total Personnel Allocations	253,920	76.5	268,209	74.6
Attorneys	129,118	38.9	132,667	36.9
Paralegals	31,864	9.6	33,436	9.3
Other Support Staff	62,401	18.8	68,670	19.1
Employee Benefits	30,537	9.2	33,436	9.3
Total Non-Personnel Allocations	78,002	23.5	91,321	25.4
Office Space	20,247	6.1	21,572	6.0
Equipment Rental	4,979	1.5	5,033	1.4
Office Supplies	8,962	2.7	10,067	2.8
Telephons	10,953	3.3	12,224	3.4
Program Travel	6,638	2.0	7,550	2.1
Training and Conference Travel	2,655	0.8	3,593	1.0
Library	4,315	1.3	4,674	1.3
Insurance	2,323	0.7	2,517	0.7
Audit	1,661	0.5	1,798	0.5
Litigation	2,655	0.8	3,236	0.9
Capital Additions	3,319	1.0	6,112	1.7
Contract Services ^{3/}	-	-	7,550	2.1
Other	9,295	2.8	5,393	1.5

^{1/} Field Program allocations include Corporation funds for Basic Field Programs, Migrant Components, Native American Components, Support Centers, Program Expansion, Program Improvement, and all Non-Corporation funds as reported in field program grant applications for Fiscal Years 1980 and 1981.

^{2/} The percentages for the budget categories were derived from field program grant applications for Fiscal Year 1980 and 1981. The estimated expenditure levels were derived by application of the percentages to total field program allocations.

^{3/} The Contract Services category was not reported prior to FY 1981.

LEGAL SERVICES CORPORATION

FIELD PROGRAM EQUAL EMPLOYMENT AND AFFIRMATIVE ACTION DATA - FISCAL YEARS 1980 AND 1981^{1/}

	<u>WHITE</u>				<u>BLACK</u>				<u>HISPANIC</u>			
	<u>FY 1980</u>		<u>FY 1981</u>		<u>FY 1980</u>		<u>FY 1981</u>		<u>FY 1980</u>		<u>FY 1981</u>	
	<u>Nr.</u>	<u>%</u>	<u>Nr.</u>	<u>%</u>	<u>Nr.</u>	<u>%</u>	<u>Nr.</u>	<u>%</u>	<u>Nr.</u>	<u>%</u>	<u>Nr.</u>	<u>%</u>
<u>ATTORNEYS</u>	<u>3,995</u>	<u>77.2</u>	<u>4,355</u>	<u>76.7</u>	<u>515</u>	<u>9.9</u>	<u>650</u>	<u>11.4</u>	<u>548</u>	<u>10.6</u>	<u>544</u>	<u>9.6</u>
Program Directors	251	81.2	259	82.5	36	11.7	34	10.8	15	4.8	13	4.1
Managing Attorneys	1,049	79.6	848	77.7	102	7.7	97	8.9	148	11.2	126	11.5
Supervising Attorneys ^{2/}	-	-	448	85.5	-	-	44	8.4	-	-	20	3.8
Staff Attorneys	2,695	76.0	2,800	74.7	377	10.6	475	12.7	385	10.9	385	10.3
<u>NON-ATTORNEYS</u>	<u>3,869</u>	<u>49.2</u>	<u>4,173</u>	<u>50.7</u>	<u>2,104</u>	<u>26.7</u>	<u>2,237</u>	<u>27.2</u>	<u>1,552</u>	<u>19.7</u>	<u>1,472</u>	<u>17.9</u>
Paralegals	1,210	50.6	1,307	50.6	637	26.6	726	28.1	429	17.9	427	16.5
Secretarial/Clerical	1,744	45.2	1,898	46.9	1,060	27.4	1,135	28.0	898	23.3	867	21.4
Prof. Non-Attorney	462	58.5	582	60.9	182	23.0	236	24.7	110	13.9	94	9.8
Other Non-Attorney	453	54.6	386	60.6	225	27.2	140	22.0	115	13.9	84	13.2

FIELD PROGRAM EMPLOYMENT AND AFFIRMATIVE ACTION DATA - FISCAL YEARS 1980 AND 1981^{1/}

(Continued)

	<u>NATIVE AMERICAN</u>				<u>ASIAN</u>				<u>TOTAL^{3/}</u>			
	<u>FY 1980</u>		<u>FY 1981</u>		<u>FY 1980</u>		<u>FY 1981</u>		<u>FY 1980</u>		<u>FY 1981</u>	
	<u>Nr.</u>	<u>%</u>	<u>Nr.</u>	<u>%</u>	<u>Nr.</u>	<u>%</u>	<u>Nr.</u>	<u>%</u>	<u>Nr.</u>	<u>%</u>	<u>Nr.</u>	<u>%</u>
<u>ATTORNEYS</u>	40	0.8	35	0.6	75	1.5	94	1.7	5,173	100.0	5,678	100.0
Program Directors	6	2.0	6	1.9	1	0.3	2	0.6	309	100.0	314	100.0
Managing Attorneys	11	0.9	8	0.7	8	0.6	12	1.1	1,318	100.0	1,091	100.0
Supervising Attorneys ^{2/}	-	-	1	0.2	-	-	11	2.1	-	-	524	100.0
Staff Attorneys	23	0.6	20	0.5	66	1.9	69	1.8	3,546	100.0	3,749	100.0
 <u>NON-ATTORNEYS</u>	 232	 2.9	 211	 2.6	 114	 1.5	 133	 1.6	 7,871	 100.0	 8,226	 100.0
Paralegals	86	3.6	87	3.4	31	1.3	37	1.4	2,393	100.0	2,584	100.0
Secretary/Clerical	104	2.7	90	2.2	53	1.4	59	1.5	3,859	100.0	4,049	100.0
Prof. Non-Attorney	17	2.2	18	1.9	19	2.4	26	2.7	790	100.0	956	100.0
Other Non-Attorney	25	3.0	16	2.5	11	1.3	11	1.7	829	100.0	637	100.0

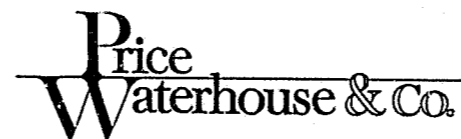
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^{1/} Fiscal Year 1980 data based on field program reports as of January 1, 1980 and do not include all staff recruited for program expansion during Calendar Year 1980. Fiscal Year 1981 data based on field program reports as of January 1, 1981 and do not include estimates of some additional staff to be recruited between January and December, 1981.

^{2/} The Supervising Attorney category was not reported prior to FY 1981. To make comparisons between the fiscal years, combine Supervising Attorneys with Managing Attorneys.

^{3/} Racial/Ethnic information was not reported for 3.9% of field program employees in 1980 and 0.6% in 1981.

LEGAL SERVICES CORPORATION
REPORT AND FINANCIAL STATEMENTS
SEPTEMBER 30, 1980 AND 1979



1801 K STREET, N.W.
WASHINGTON, D. C. 20005
202-298-0800

November 19, 1980

To the Board of Directors of
Legal Services Corporation

We have examined the balance sheets of Legal Services Corporation as of September 30, 1980 and 1979, and the related statements of support, revenue and expenses and changes in fund balances and of functional expenses for the year ended September 30, 1980. Our examinations were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying financial statements examined by us present fairly the financial position of Legal Services Corporation at September 30, 1980 and 1979, and the results of its operations and changes in its fund balances for the year ended September 30, 1980, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Price Waterhouse & Co.

LEGAL SERVICES CORPORATION
BALANCE SHEET
SEPTEMBER 30

	<u>1980</u>	<u>1979</u>
<u>ASSETS</u>		
Cash in Treasury (Note 6)	\$42,955,107	\$63,263,442
Cash	1,306,408	1,958,967
Temporary cash investments, principally treasury bills, at cost which approximates market (Note 6)	2,640,095	3,691,802
Accrued interest receivable	27,142	78,886
Grants and accounts receivable, and travel advances	662,130	129,358
Properties, net of accumulated depreciation and amortization of \$502,911 and \$320,084	1,155,979	1,160,254
Other assets	<u>73,809</u>	<u>62,821</u>
Total assets	<u>\$48,820,670</u>	<u>\$70,345,530</u>

LIABILITIES AND FUND BALANCES

Liabilities:

Unpaid grants and contracts	\$33,094,302	\$48,620,130
Accounts payable	1,935,241	1,511,696
Accrued vacation and other liabilities	<u>483,824</u>	<u>362,266</u>
Total liabilities	<u>35,513,367</u>	<u>50,494,092</u>
Commitment (Note 4)		
Fund balances (Note 5):		
Federal appropriation	9,558,266	16,124,317
General	2,593,058	2,566,867
Net investment in properties	<u>1,155,979</u>	<u>1,160,254</u>
Total fund balances	<u>13,307,303</u>	<u>19,851,438</u>
Total liabilities and fund balances	<u>\$48,820,670</u>	<u>\$70,345,530</u>

(See Notes to Financial Statements)

LEGAL SERVICES CORPORATION
STATEMENT OF SUPPORT, REVENUE AND EXPENSES AND CHANGES
IN FUND BALANCES FOR THE YEAR ENDED SEPTEMBER 30, 1980
WITH COMPARATIVE TOTALS FOR 1979

	<u>General</u>	<u>Federal Appropriation</u>	<u>Properties</u>	<u>1980</u>	<u>Total</u>	<u>1979</u>
<u>Support and Revenue (Note 2)</u>						
Federal appropriation						
Grants		\$300,000,000		\$300,000,000	\$270,000,000	
Donated services	\$ 765,327			765,327		
Interest income	74,123			74,123		79,527
	437,413			437,413		468,403
Total support and revenue	<u>1,276,863</u>	<u>300,000,000</u>		<u>301,276,863</u>		<u>270,547,930</u>
<u>Expenses (Note 2)</u>						
<u>Program activities:</u>						
Grants and contracts	273,057	290,796,628		291,069,685		250,484,135
Program services	974,132	10,693,867	54,273	11,722,272		11,487,290
Total program activities	<u>1,247,189</u>	<u>301,490,495</u>	<u>54,273</u>	<u>302,791,957</u>		<u>261,971,425</u>
<u>Supporting activities:</u>						
Grants and contracts		92,050		92,050		35,896
Management and administration		4,805,766	131,225	4,936,991		4,691,278
Total supporting activities		<u>4,897,816</u>	<u>131,225</u>	<u>5,029,041</u>		<u>4,727,174</u>
Total expenses	<u>1,247,189</u>	<u>306,388,311</u>	<u>185,498</u>	<u>307,820,998</u>		<u>266,698,599</u>
Excess of support and revenue (expenses)	29,674	(6,388,311)	(185,498)	(6,544,135)		3,849,331
Fund balances at beginning of year	2,566,867	16,124,317	1,160,254	19,851,438		16,002,107
<u>Interfund Transfer</u>						
Acquisition of properties	(3,483)	(177,740)	181,223			
Fund balances at end of year (Note 5)	<u>\$2,593,058</u>	<u>\$ 9,558,266</u>	<u>\$1,155,979</u>	<u>\$ 13,307,303</u>		<u>\$ 19,851,438</u>

(See Notes to Financial Statements)

CONTINUED

1 OF 5

LEGAL SERVICES CORPORATION
 Insufficient Copies Request
 for Audit Report and Supplemental Letter

RASOP-II

//

Dear //:

I have received // of the audit report and // of the related supplemental letter dated // for the period ended //. The audit report and supplemental letter were prepared by //. Please note that page 5-1 of LSC's Audit and Accounting Guide for Recipients and Auditors (revised June 1977) requires that three copies of the audit report and supplemental letter be submitted to LSC and one copy of each to the regional director.

We are required by the Legal Services Corporation Act (as amended 1977) to make a certain distribution of the audit reports. The number of copies designated in LSC's "Audit Guide" is necessary for our needs. Therefore, please provide me with // additional // of the audit report and // additional // of the supplemental letter.

Sincerely,

//
 Audit Senior

ML://

cc: //
 Patrick J. Yogus, Audit Manager

NOTE: RASOP-III will be a Xerox of this letter stamped "2nd Request"
 (sent 2 weeks after 1st request).

LEGAL SERVICES CORPORATION
 Request for Supplemental Letter

RASOP-II/a

//

Dear //:

I have received a copy of the // audit report of // which was prepared by //. A supplemental letter commenting on the auditor's review of your program's internal controls was not included as part of the report. This information is required by Legal Services Corporation's Audit and Accounting Guide for Recipients and Auditors (revised June 1977).

LSC's Audit Guide states that in addition to rendering his opinion on the financial statements, the auditor is required to issue a supplemental letter. The supplemental letter, which must be submitted in addition to the financial statements, is designed to provide greater insights into the recipient's financial management than normally reflected in financial statements. The letter is intended for the recipient's management and LSC, and would not normally have any wider distribution. The auditor must comment in the supplemental letter on the following specific items to the extent they are observed within the scope of his examination.

1. Suggestions for improvements in internal control procedures.
2. The status of the prior year's internal control comments, questioned costs comments, or other comments.
3. Significant and unusual transactions occurring during the year.
4. Compliance with the financial and accounting conditions of the grant or contract.
5. Whether the costs incurred during the period are eligible to be charged to LSC funds.

In addition to the auditor's comments on the preceding items, the supplemental letter must also contain the following exhibit:

A summary of questioned costs considered ineligible under LSC's criteria and the recipient's comments thereon.

Please provide me with three copies of your supplemental letter so that I may complete the review of the audit.

Sincerely,

//
Audit Senior

//
cc: //, Regional Director
Patrick J. Yogus, Audit Manager

LEGAL SERVICES CORPORATION

RASOP-II/b

Request for Termination Audit Supplemental Letter

//

/

/

Dear //:

I have received a copy of the // termination audit report of // which was prepared by //. A supplemental letter commenting on the auditor's review of the program's internal controls was not included as part of the report. This information is required by Legal Services Corporation's Audit and Accounting Guide for Recipients and Auditors (revised June 1977).

Because of the termination of LSC funding, LSC can waive the requirement for a supplemental letter commenting on the internal control deficiencies of the program. However, as a minimum, LSC will require a statement from the auditor that indicates that costs were reviewed in accordance with LSC's eligibility criteria and describes the status of the review. This statement requires no additional audit work since the auditor need only comment on those items which came to his attention during the scope of his examination of the financial statements. No additional audit work assumes the auditor did utilize LSC's audit guidelines.

If no questioned costs were noted during the auditor's examination, we will require a statement to this effect from the auditor. If questioned costs were noted, the statement must contain a summary of the costs considered ineligible under LSC's criteria for such costs.

If you have any questions concerning LSC's requirement in this regard, please do not hesitate to call me. Please provide me with this information as soon as possible so that I may complete the review of the termination audit.

Sincerely,

//
Audit Senior

ML://
cc: //
Patrick J. Yogus, Audit Manager

LEGAL SERVICES CORPORATION
Second Request for Supplemental Letter

RASOP-III/a

//

/

/

Dear //:

On //, I sent a letter to you requesting three copies of the supplemental letter prepared by // commenting on the auditor's review of the internal controls at // for the fiscal period ended //. To date, we have not received the requested copies of this supplemental letter.

This information is required by LSC's Audit and Accounting Guide (revised June 1977) to be submitted to LSC in addition to the financial statements. Therefore, I am again requesting three copies of your supplemental letter so that I may complete the review of your audit.

Sincerely,

//
 Audit Senior

ML://

cc: //
 Patrick J. Yogus, Audit Manager

LEGAL SERVICES CORPORATION
Third Request for Supplemental Letter

RASOP-IV

MEMORANDUM

DATE: //
 TO: // (regional director)
 FROM: //
 SUBJECT: THIRD REQUEST FOR SUPPLEMENTAL LETTER

On //, I sent a letter to //, director of //, requesting three copies of the supplemental letter for the fiscal period ended //, which was prepared by //.

A second request was sent to the program director on //. However, as of the date of this memorandum, the Comptroller's Office has not received copies of the requested reports.

I would appreciate your contacting the program directly to obtain the required copies of the supplemental letter for our files so that we may complete our review. Thank you for your assistance.

ML://

cc: Clinton Lyons, Director of Field Services
 Patrick J. Yogus, Audit Manager
 // (program director)

LEGAL SERVICES CORPORATION RASOP-V
 DESK AUDIT DOCUMENTATION FORM
 PROCESSING PROCEDURES AND GUIDELINES

General

The desk audit by LSC's audit staff of annual audit reports is documented on a standard "Desk Audit Documentation (DAD) Form" (a copy is attached). The DAD Form serves several purposes:

1. Documentation The DAD Form documents the fact that a recipient's audit report has been desk audited in accordance with LSC's Standard Operating Procedures for Recurring Recipient Audits (SOP's). The SOP's are designed to identify deficient audit reports; and also to identify operating problems or deficiencies that exist at recipients.
2. Communication The DAD Form highlights for the monitoring office director, the program director, and the program auditors, items that represent deficiencies or items that may indicate potential future problems. The affected individuals are thus given notice of the areas that deserve management attention so they can ensure deficiencies are remedied or potential problems are averted.
3. Instruction The DAD Form will be accompanied by a memo which emphasizes actions which are required by the appropriate individuals under circumstances such as:
 - a. Audit report being unacceptable due to magnitude of noncompliance with LSC guidelines, errors, missing information, etc.
 - b. Supplemental letter identifying major operational problems that require timely attention and disposition by LSC in order to demonstrate the full discharge of our stewardship responsibilities.

Initial Preparation and Completion of DAD Form

- Items 1 thru 6: Much of the heading information of the DAD Form will be completed upon receipt of the audit report. At the time the Audit Department secretary logs in the report, he/she will complete DAD Form items 1 through 6. The

information to complete items 1 through 6 can be extracted from the audit report, the supplemental letter, and from other documentation maintained in the audit control files.

- Items 7 & 8: To determine the number of days the audit report is delinquent:
- (a) compute the number of days subsequent to the recipient's fiscal year-end, that the report had been received by LSC;
 - (b) deduct the 90-day reporting requirement; and
 - (c) deduct any extensions authorized by the regions (up to 60 days).
- Item 8: (c) deduct any extensions authorized by the regions (up to 60 days).
- Item 7: The remainder represents the number of days delinquent.
- Item 9: After each audit report is logged in, the audit report and DAD Form will be given to the audit senior assigned the responsibility for prioritizing audit reports as either "Priority" reports or "Non-Priority" reports. This prioritization is made in accordance with criteria identified in LSC's Recurring Audit SOP's. The assigned audit senior maintains a current listing of all "Priority" reports.
- Items 10 & 11: Item 10 is signed and dated by the audit senior who performs the Desk Audit in accordance with LSC's Guidelines for Desk Auditing Recipient Audit Reports and completes the comments on the Audit Review Categories 1 through 15. Item 11 is signed and dated by the audit senior assigned the 2nd review responsibility.
- One audit senior will be assigned the responsibility to read each DAD Form for consistency of application of Audit Department standards and criteria before it is distributed.
- Item 12: "Correspondence Required" will be checked when a response to the Comptroller's Office Audit Department is required. It will be checked in all instances described under General 3. Instruction (a) & (b) above. It may be checked under other circumstances when stewardship or other considerations deem it appropriate that the Comptroller's Office receive a positive response on an issue.
- The Audit Department secretary will maintain a tickler file for all of these items.

Internal Follow-up Notes

This section of the DAD Form will be used as a status report section to document results of follow-up efforts or to make other internal notes.

Audit Review Categories

The major areas of significance in the audit report are categorized in the Audit Review Categories 1 through 15. The results of the audit staff's desk audit will be documented on the face of the DAD Form with a notation indicating "exception" or "no exception" next to the categorized items. The subsequent pages of the DAD Form will be used to expand exception comments. Any exception comments will be referenced to the appropriate category by a letter.

The referenced comments highlight for the monitoring office, the program director, and the program auditor the problem areas noted during the desk audit by the LSC audit staff. Exception comments will identify and describe the nature of the exception but will not suggest the follow-up action to be taken by the monitoring office unless the situation falls under the "Correspondence Required" category.

Distribution of DAD Form

Internally, the original DAD Form will serve as the recipient file copy and the Audit Manager's copy. This form will be circulated among all members of the audit staff subsequent to release of the DAD Form and filed with the recipient's audit report in the recipient audit file. An additional copy of the DAD Form will be maintained by the Audit Department secretary in a "Desk Audit Chron File" used exclusively for that purpose.

Externally, the DAD Form will be distributed to the monitoring office director, the program director, and the program auditor.

ML/PJY:de
Attachments

LEGAL SERVICES CORPORATION
DESK AUDIT DOCUMENTATION FORM

- 1. Recipient No. _____
- 2. Recipient Name _____
- 3. Audit Period _____
- 4. Supplemental Letter Dated _____
- 5. Date Received by LSC _____
- 6. Independent Auditor _____
- 7. Days Delinquent _____
- 8. Extension(s) Authorized by Region ____ Days
- 9. Prioritized by: _____ Date: _____
 Priority Non-Priority
- 10. Desk Audit _____ Date: _____
- 11. Reviewed by: _____ Date: _____
- 12. Correspondence Required Not Required

Internal Follow-up Notes:

AUDIT REVIEW CATEGORIES	EXCEPTION		AUDIT REVIEW CATEGORIES	EXCEPTION	
	NO	YES		NO	YES
1. Auditor eligibility			9. Other areas relating to compliance with LSC Audit Guide, GAAP or GAAS		
2. Use of Audit Guide documented			10. Status of LSC fund balance (Material Deficits, Excesses)		
3. Unqualified opinion			11. Status of total fund balances (Material Deficits, Excesses)		
4. Opinion covers all appropriate statements			12. Internal control weaknesses		
5. Support, Expenses, Fund Balances by Source of Funds			13. Questioned costs		
6. Proper recognition of LSC support			14. Unusual transactions/Grant Compliance		
7. Tie-in of beginning fund balances			15. Other required comments (Unusual disclosure in audit report, correspondence in our files, etc.)		
8. All resource audit					

LEGAL SERVICES CORPORATION
DESK AUDIT DOCUMENTATION FORM (COMMENTS)

Comments--keyed to exceptions on page 1:

cc: Monitoring Office Director
Program Director
Program Auditor

Page ___ of ___

EXHIBIT III



LEGAL SERVICES CORPORATION
733 Fifteenth Street, N.W., Washington, D. C. 20005 (202) 376-5100

Thomas Ehrlich
President
E. Clinton Bamberger, Jr.
Executive Vice-President

MEMORANDUM

DATE: April 9, 1979

TO: OFFICES WITH PROGRAM MONITORING RESPONSIBILITY (Office of Field Services, Office of Program Support, Delivery Systems Study, Quality Improvement Program)

FROM: Fabio de la Torre, Comptroller

SUBJECT: COMPTROLLER'S OFFICE STANDARD OPERATING PROCEDURES RELATING TO NEW RECIPIENTS

Section 1009(c)(1) of the Legal Services Act as amended 1977 states:

"The Corporation shall conduct or require each grantee, contractor, or person or entity receiving financial assistance under this title to provide for an annual financial audit..."

The standard operating procedures relating to recipient audits must be enhanced to ensure that new recipients can satisfy LSC's financial and audit requirements before they are entrusted with significant amounts of LSC funds.

The purpose of this memo is to define responsibilities and objectives and to update and supercede the standard operating procedures defined in my memo of April 25, 1977. I will appreciate any comments or suggestions you have which will lead to a more effective program.

GENERAL

The "new recipient" category can encompass a variety of circumstances, among which are:

- existing programs which have not been previously funded by LSC,
- newly formed programs,
- recipients previously funded as a delegate agency through a Community Action Program,
- spin-offs from existing LSC programs,
- new programs funded for demonstration purposes, quality improvement purposes, or other non-typical purposes.

New recipients in many cases do not have experience in accounting or the capabilities to handle expanded accounting requirements, yet must immediately assume these accounting responsibilities. Newly formed organizations must develop and implement adequate accounting procedures and internal controls. The procedures set forth in this memo attempt to establish guidance to assist the monitoring offices and the Comptroller's Office in discharging their respective responsibilities in a specific area -- new recipients.

OBJECTIVES

The mutual objective of the monitoring offices and the Comptroller's Office with respect to the categories of recipients listed above is:

Ensure that the recipient has the capabilities to account for and safeguard the funds awarded to it by LSC prior to expending significant amounts of these funds.

PROCEDURES AND RESPONSIBILITIES

AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>A. Notification of Comptroller's Office</p> <p>1. Upon receipt of the grant application or other notification, the Comptroller's Office will extract the relevant information and create a permanent file and the appropriate audit control cards.</p> <p>a. Relevant information includes:</p> <ol style="list-style-type: none"> 1) Name of program 2) Address of program 3) Telephone number 4) Director or contact person 5) Grant number 6) Effective date of award 7) Date of first cash disbursement to the recipient <p>b. Control cards will be prepared for the master card file for annual audits and a control card will be prepared to monitor the satisfaction of the initial evaluation requirement and notification of fiscal year-end.</p>	<p>A. Notification of Comptroller's Office</p> <p>1. The monitoring office will notify the Comptroller's Office Audit Department as soon as it becomes apparent that a funding action will be approved for a program which has not been subject to LSC audit procedures in the past. (The earlier the notification, the more effective the procedures.)</p> <p>As a means of notification, the monitoring office should route all approved applications for funding to the Comptroller's Office. If this means of notification is not timely or sufficient in certain circumstances to meet the above responsibility, notification should be by means of a memo or telephone call.</p>

PROCEDURES AND RESPONSIBILITIES

AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>A. Notification of Comptroller's Office (Continued)</p> <p>2. The Accounting Department will furnish the Audit Department with copies of approved grant applications that initiate the funding of the new recipients. These will be compared to information received directly from the monitoring office, if any.</p>	<p>A. Notification of Comptroller's Office (Continued)</p> <p>2. N/A</p>
<p>B. Notification of Recipients</p> <p>1. Upon receipt of notification from the monitoring office of the funding or potential funding of a new recipient, the Comptroller's Office will send a standard letter to the new recipient advising them of LSC's initial fiscal requirements. (NRSOP - ATTACHMENT I) A copy of the letter will be sent to the monitoring office director. The contents of that letter will include the following:</p> <p>a. The recipient will be advised that as a condition to accepting a grant from Legal Services Corporation they have agreed to provide for an initial evaluation of their accounting system and internal controls as well as provide for an annual financial audit conducted by an independent accountant who has met the eligibility guidelines in LSC's <u>Audit and Accounting Guide for Recipients and Auditors</u>.</p> <p>b. Guidance necessary to comply with the provision for the initial evaluation will be provided.</p>	<p>B. Notification of Recipients</p> <p>1. N/A</p> <p>a. The monitoring office should insure that the grant application for any applicant included within the "new recipient" category includes an assurance that the recipient will provide for an initial evaluation of its accounting system and internal controls in accordance with instructions from the Comptroller's Office.</p> <p>b. N/A</p>

PROCEDURES AND RESPONSIBILITIES

AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
B. Notification of Recipients (Continued)	B. Notification of Recipients (Continued)
c. The recipient will be advised that the initial evaluation is due within 30 days after the date of the first cash disbursement to the program.	c. N/A
d. As an alternative to providing an initial evaluation, the new recipient will be notified that if it is an existing program and has recent audited financial statements, they may be submitted to LSC along with a copy of the auditor's supplemental letter. This information may satisfy LSC's objective in lieu of the initial evaluation report.	d. N/A
e. The general standards of accountability and financial reporting that LSC expects recipients to maintain will be enumerated.	e. N/A
f. LSC's <u>Audit and Accounting Guide for Recipients and Auditors</u> , LSC's <u>Accounting Model for Recipients</u> , and LSC's <u>Fundamental Criteria of an Accounting and Financial Reporting System for LSC Recipients</u> will be provided to recipients not already having access to copies.	f. N/A
g. The recipient will be advised of the assistance that may be available from LSC.	g. N/A
h. The recipient will be requested to notify the Comptroller's Office of the fiscal year that it has chosen as soon as this information is determinable. Guidelines will be provided for making this decision.	h. N/A

PROCEDURES AND RESPONSIBILITIES

AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
B. Notification of Recipients (Continued)	B. Notification of Recipients (Continued)
2. Some new recipients are spin-off operations from existing programs funded by LSC, and some are former delegates of agencies funded by LSC. In these cases the grant document executed may be an application for refunding rather than for initial funding. The agreement to provide for an initial evaluation of the recipient's accounting procedures and internal controls is omitted from the assurances in a refunding application.	2. The monitoring office should be alert to situations in which a refunding action results in awarding funds to a recipient which has not had previous accounting responsibilities. In such cases the monitoring office should consider the recipient as a "new recipient" for accounting and audit purposes. In these circumstances the monitoring office should consider including the requirement for an initial evaluation in the grant assurances.
The initial accounting evaluation is not necessary for those circumstances where the "new recipient" represents existing operations under accounting procedures and internal controls already subject to LSC audit procedures. However, for those circumstances where the new recipient has not been subject to LSC audit procedures in the past, it is necessary for LSC to be assured that the new recipient can account for and safeguard its resources. An initial evaluation must be required, even though it may not have been included as an assurance given by the applicant on the grant document. Therefore, for new recipients funded through a refunding action, the Audit Department will send the standard letter to the applicant, modified by the following requirements (based upon the circumstances of the situation):	

PROCEDURES AND RESPONSIBILITIES

AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>B. Notification of Recipients (Continued)</p> <p>a. If the Comptroller's Office has current financial statements and a supplemental letter on file for the applicant which reflect adequate procedures and controls, the Comptroller's Office will require:</p> <p>1) that the applicant send a letter to the Comptroller's Office representing that the procedures and controls existing as of the date of the financial statements are still in effect and have continuously been under the management of the new recipient. This is necessary because it is not possible to tell, for example, whether the financial statements that LSC has on file for a former delegate agency were prepared from accounting data maintained by the program itself, or maintained by the delegating organization; or</p> <p>2) if an existing accounting system will be assumed by the new recipient subsequent to direct funding, then an initial evaluation of the accounting system and internal controls will be required.</p> <p>b. If the Audit Department does not have current financial statements on file, or if it is clear that the financial statements on file do not relate to the new recipient, then an evaluation will be required. Reference will not be made to the grant assurances as containing the requirement for this evaluation, unless the regions have included this requirement among the grant assurances.</p>	<p>B. Notification of Recipients (Continued)</p> <p>a. N/A</p> <p>1) N/A</p> <p>2) N/A</p> <p>b. N/A</p>

PROCEDURES AND RESPONSIBILITIES

AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>C. Follow-up on Recipient's Fiscal Year-end</p> <p>The Comptroller's Office will follow-up with new recipients (and the monitoring office as necessary) to discern the fiscal year-end chosen by the program if a response had not been obtained from the request contained in the Comptroller's Office initial letter to the recipient.</p> <p>D. Receipt of Reports</p> <p>1. (Receipt of financial statements and supplemental letter.) The Comptroller's Office will review the financial statements and supplemental letter as they are received and respond as follows:</p> <p>a. If the financial information is sufficiently current (usually less than one year old) and provides assurance that the recipient's accounting system and internal controls are adequate, the Comptroller's Office will notify the recipient that the initial evaluation requirement has been waived, as well as note any significant items disclosed in the financial statements which would necessitate action in bringing the program into full compliance with LSC's financial reporting and accounting guidelines.</p> <p>b. If the financial statements and supplemental letter do not provide the assurance that is necessary, the recipient will be notified why, and the initial evaluation as originally agreed upon in the grant document will be required.</p>	<p>C. Follow-up on Recipient's Fiscal Year-end</p> <p>N/A</p> <p>D. Receipt of Reports</p> <p>1. N/A</p> <p>a. The monitoring office is responsible for ensuring that any deficiencies noted in the financial statements or recommendations made by the Audit Department are adequately resolved by the recipient.</p> <p>b. N/A</p>

PROCEDURES AND RESPONSIBILITIES

AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>D. <u>Receipt of Reports (Continued)</u></p> <p>2. (Receipt of initial evaluation.) The Comptroller's Office will review the evaluations as they are received and respond as follows:</p> <p>a. If the initial evaluation was correctly prepared in accordance with generally accepted auditing and reporting standards, and if the evaluation indicates the recipient's accounting procedures and internal controls are adequate, then LSC will confirm with the recipient that the initial evaluation requirement has been met. A copy of the confirmation will be sent to the monitoring office director.</p> <p>b. If the initial evaluation discloses deficiencies in the recipient's systems and procedures or renders an overall unsatisfactory opinion regarding the recipient's procedures, then the recipient will be notified that the evaluation requirement has been met. However, the recipient will be instructed to correct those deficiencies disclosed by the auditors that represent departures from LSC's Fundamental Criteria.</p>	<p>D. <u>Receipt of Reports (Continued)</u></p> <p>2. N/A</p> <p>a. N/A</p> <p>b. The monitoring office is responsible for ensuring that the recipient correct or otherwise appropriately respond to deficiencies noted in the initial evaluation. It will be the responsibility of the monitoring office to advise the Comptroller of any withholding actions or other changes in the recipient's funding schedule that may be required.</p>

PROCEDURES AND RESPONSIBILITIES

AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>D. <u>Receipt of Reports (Continued)</u></p> <p>c. The evaluation may not be satisfactory due to the preparation of the report. Deficiencies in the preparation of the report can result from either deficiencies in the work performed by the auditors or deficiencies in the content or format of the report itself. The Comptroller's Office will inform the recipient, the monitoring office, and the auditor that the requirement has not been met and will provide guidance necessary to satisfy the requirement, depending on the circumstances of the situation.</p> <p>E. <u>Delinquent Initial Evaluation</u></p> <p>1. The Comptroller's policy is that initial evaluations must be submitted to LSC within 30 days of the first cash disbursement to the recipient.</p>	<p>D. <u>Receipt of Reports (Continued)</u></p> <p>c. If the Comptroller's Office fails to receive an acceptable initial evaluation within its required time frame; the monitoring office will consider the initial evaluation to be delinquent and will follow the procedures described below for delinquent initial evaluations.</p> <p>E. <u>Delinquent Initial Evaluation</u></p> <p>1. It will be the monitoring office's responsibility to monitor the activities of the new recipient and assure that the initial evaluation is provided to the Comptroller's Office in the 30-day time requirement. The monitoring office may authorize two 30-day extensions of the initial 30-day time period for submission of evaluations if the program is not staffed or there are other valid reasons causing delay in the preparation of the evaluation. The Comptroller's Office should be notified of extensions granted.</p> <p>A meaningful evaluation of the operation of procedures and controls in effect may not be obtainable for programs that are not operational within 30 days of the first cash disbursement from LSC. However, an evaluation of provisions for an accounting system and internal controls can be achieved prior to the time program services are actually initiated. The auditors may only be able to review systems and procedures identified, rather than be</p>

AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>E. Delinquent Initial Evaluation (Continued)</p> <p>2. If, at the end of 30 days subsequent to the disbursement of the first payment, the recipient has not responded with either an initial evaluation or the previous year's financial statements and supplemental letter; or if the Comptroller's Office has not been notified by the monitoring office that an extension has been granted, the Comptroller's Office will investigate the facts of the circumstances with both the recipient and the monitoring office, if necessary. The Comptroller's Office will send a second letter to the program with contents depending upon the circumstances:</p> <p>a. If the recipient has an accounting and internal control system, then depending upon the reasons disclosed in the follow-up investigation, the Comptroller's Office will confirm that the evaluation is overdue and is expected as soon as its completion is practicable in the circumstances. A specific date will be confirmed using a standard letter (NRSOP-Attachment II).</p>	<p>E. Delinquent Initial Evaluation (Continued)</p> <p>able to test the operation of those procedures. However, the review will give LSC the assurance that adequate provisions are being made to account for and safeguard LSC funds. Extensions granted for the submission of the initial accounting evaluation should therefore be based upon whether the new organization has identified a management staff capable of responding to the responsibility of implementing, or contracting to implement, an accounting system, rather than when the program is anticipated to be fully operational.</p> <p>2. N/A</p> <p>a. The monitoring office may support the Comptroller's Office requirement through independent communication with the recipient if considered appropriate in the circumstances.</p>

PROCEDURES AND RESPONSIBILITIES	
AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>E. Delinquent Initial Evaluation (Continued)</p> <p>b. If the recipient is a newly organized program and does not have an accounting and internal control system, the program will be advised by a second letter to arrange for the implementation of an accounting system and engage independent accountants eligible under LSC guidelines to evaluate the system as soon as practicable. The recipient will be advised that the implementation and evaluation of an accounting system can be achieved prior to the initiation of program services. A specific due date will be confirmed; however, the recipient will be requested to advise the monitoring office director if an extended delay is anticipated. The monitoring office director will consult with the Audit Manager and Comptroller regarding the funding policy that should be followed in such circumstances. (See standard letter NRSOP - Attachment III.)</p> <p>3. Subsequent to the initial follow-up procedures described above, the Comptroller's Office will continue to follow-up on delinquent outstanding initial evaluations as follows:</p> <p>a. For programs that remain delinquent after the second deadline specified in the initial follow-up effort, the Comptroller's Office will send a standard memo (NRSOP - ATTACHMENT IV) to the monitoring office director with a copy to the recipient indicating that the Comptroller's Office determined that the recipient does not meet</p>	<p>E. Delinquent Initial Evaluation (Continued)</p> <p>b. The monitoring office has the obligation to assure itself that the recipient can account for and safeguard the funds received from LSC until the program implements an accounting system and an independent evaluation can be rendered. As a means of effectively meeting the practical circumstances of the programs and LSC's responsibility to safeguard and effectively administer all funds entrusted to it; the Comptroller's Office recommends that the monitoring offices consider delaying where practicable, monthly checks to newly formed programs beyond amounts necessary to support the program during the start-up phase. The Comptroller's Office would defer monthly checks until authorized to continue sending them by the monitoring office director.</p> <p>3. N/A</p> <p>a. The monitoring office director will advise the Comptroller's Office with respect to the action he/she intends to take, or has taken, regarding recipients who have not complied with LSC's initial evaluation procedures.</p>

PROCEDURES AND RESPONSIBILITIES

AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>E. Delinquent Initial Evaluation (Continued)</p> <p>the accounting requirements necessary to be eligible to continue to receive LSC funds.</p> <p>b. The Comptroller's Office will advise the monitoring office monthly of:</p> <ul style="list-style-type: none"> - those recipients who could not initially respond to the initial evaluation requirement because they did not have staff, and have not subsequently satisfied the requirements; and - those recipients who were advised that they were ineligible to receive LSC's funds under LSC's accounting and financial reporting guidelines. 	<p>E. Delinquent Initial Evaluation (Continued)</p> <p>It is the monitoring office's responsibility, in consultation with the Comptroller's Office, to determine the conditions under which LSC will continue to fund a recipient not complying with LSC fiscal requirements.</p> <p>b. It is the monitoring office's responsibility to ensure that the evaluation is subsequently satisfied by those unstaffed recipients for which an interim funding policy has been established to temporarily satisfy the monitoring office in lieu of the initial evaluation.</p> <ul style="list-style-type: none"> - It is the monitoring office's responsibility to ensure that the conditions (see a. above) under which LSC continues to fund recipients not eligible for funds under LSC's accounting and financial reporting guidelines are fully complied with by the recipient.

LEGAL SERVICES CORPORATION

MRSOP-I

Initial Evaluation -- 1st Standard Letter

Sent pursuant to notification of funding of a new recipient

(All New Recipients)

0 //

Dear // (S)

Our // (S) asked me to advise you of the fiscal requirements associated with accepting a (S) from Legal Services Corporation (LSC). The purpose of this letter is to respond to that request, as well as provide you with the guidance necessary to comply with the fiscal provisions should an award be made to your program.

As standard conditions to accepting a (S) from Legal Services Corporation, recipients must:

- install and maintain an accounting system and internal controls in accordance with the standards and procedures prescribed in LSC's Audit and Accounting Guide for Recipients and Auditors (Audit Guide) and LSC's Fundamental Criteria of an Accounting and Financial Reporting System for LSC Recipients (Fundamental Criteria);
- provide LSC, within 30 days after LSC funding commences, an initial evaluation by an independent accountant (eligible to perform the evaluation under LSC guidelines) of your accounting system and internal controls; (guidance from the Comptroller's Office of the Corporation is included with this letter);
- provide LSC annually, within 90 days after your fiscal year-end, audited financial statements and auditors' supplemental letter prepared in accordance with LSC's Audit Guide.

As a new recipient, your immediate concern will be to satisfy LSC's requirement for an initial evaluation of your accounting system and internal controls.

The objective of the initial evaluation is to ensure that the recipients of Legal Services Corporation's funds can adequately account for and safeguard those funds. I have attached to this letter some explanatory paragraphs that will provide your auditors with guidelines to assist them in evaluating your accounting system and internal controls. For your purposes, the paragraphs summarize the standards of accountability that LSC expects recipients to maintain.

If your program has recent audited financial statements, I suggest you submit them to us, along with a copy of your auditors' supplemental letter addressed to the board of directors. This information may satisfy LSC's objectives in lieu of the initial evaluation report. After review of your financial statements and supplemental letter, I will advise you as to whether the initial evaluation requirement can be waived, as well as note any significant items in your audit report which will require your attention to bring your program into full compliance with LSC's accounting and financial reporting guidelines.

I have enclosed two copies of LSC's Audit Guide and LSC's Fundamental Criteria for use in conjunction with the initial evaluation and subsequent annual audit. The Guide and Criteria describe the accounting policies, records, and internal control standards and procedures considered adequate to provide proper accounting, reporting, and financial management of a recipient program. I have also enclosed our publication, Accounting Model for Recipients. This booklet discusses the concepts and objectives of the principles, procedures, and guidelines set forth in LSC's Audit Guide and Fundamental Criteria. The Model was developed during LSC's involvement in the implementation of an accounting system for a recipient in New Mexico. A detailed accounting procedures manual was also developed at that program to implement the objectives and concepts discussed in the Model. A copy of the procedures manual is available upon request. These publications should be helpful as guidelines in implementing an adequate accounting and financial reporting system. However, they must be adapted to fit your own specific needs.

We will expect to receive recent audited financial statements and the related auditors' supplemental letter, or your auditors' report on the initial evaluation of your accounting system and controls within 30 days after LSC funding actually commences. Although you may not become fully operational until some time after funding commences, the identification and implementation of an accounting system can predate the time when program services are actually initiated. It is also possible for your independent accountants to review a system and comment upon its adequacy prior to the program becoming fully operational. The independent accountant's representation in such circumstances is, of course, that the adequacy of the system is contingent upon compliance with the procedures and controls that have been provided for.

It is also requested that you notify the Comptroller's Office of your fiscal year-end. LSC does not require any particular fiscal year; however, the Audit Guide provides guidelines for determining which year-end may be optimal for your program. Please do not hesitate to call the Comptroller's Office if you have questions regarding the requirements discussed in this letter.

Sincerely,

Patrick J. Yogus
Audit Manager

PJY://

Enclosures

① cc: Fabio de la Torre
//, Regional Director

EXHIBIT IV



LEGAL SERVICES CORPORATION

MEMORANDUM

DATE: April 9, 1979

TO: OFFICES WITH PROGRAM MONITORING RESPONSIBILITIES (Office of Field Services, Office of Program Support, Delivery Systems Study, Quality Improvement Program)

FROM: Fabio de la Torre, Comptroller

SUBJECT: COMPTROLLER'S OFFICE STANDARD OPERATING PROCEDURES RELATING TO TERMINATION AUDIT REPORTS

Section 1009(c)(1) of the Legal Services Corporation Act as amended 1977 states that:

"The Corporation shall conduct, or require each grantee, contractor, or person or entity receiving financial assistance under this title to provide for, an annual financial audit...."

The purpose of this memo is to define responsibilities and objectives which will allow the monitoring offices and the Comptroller's Office to ensure that LSC's assets and support are being fully accounted for and audited whenever there is a structural change in a program which is funded by Legal Services Corporation. I will appreciate any comments or suggestions you have which will lead to a more effective program.

GENERAL

Structural changes in recipients which may necessitate a termination audit report include:

- Two or more LSC recipients consolidating to form a new LSC recipient;
- One or more LSC recipients merging into an existing LSC recipient;
- One or more non-LSC recipients merging into an existing LSC recipient;
- One or more LSC recipients merging into an existing non-LSC recipient;
- Defunding of a recipient.

OBJECTIVES

The mutual objectives of the Comptroller's Office and the monitoring office with respect to the termination audit reports are to:

1. Establish procedures for timely reporting to the appropriate offices of the Legal Services Corporation mergers, consolidations, defunding actions, and other occurrences which would precipitate audit ramifications.
2. Ensure that there is complete reporting of and accountability for LSC support, expenditures, assets, liabilities, and fund balances and that continuity of the reporting periods has been maintained.
3. Ensure that the surviving entity has the capability to account for and safeguard the funds transferred to it by the terminated recipient.
4. Ensure that the financial aspects of the successor-in-interest, or other agreements, are complied with to the extent that compliance can be ascertained from the review of the applicable termination audit reports.

PROCEDURES AND RESPONSIBILITIES	
AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>I. <u>NOTIFICATION OF COMPTROLLER'S OFFICE</u></p> <p>A. Upon receipt of the successor-in-interest agreement or other notification, the Audit Department will extract the relevant information and create or update appropriate audit control cards.</p> <ol style="list-style-type: none"> 1. Name of recipient. 2. Address of recipient. 3. Telephone number. 4. Director or contact person. 5. Recipient number. 6. Termination or combination date. 7. Circumstances of the termination or combination. 8. Recipient's auditors. 	<p>J. <u>NOTIFICATION OF COMPTROLLER'S OFFICE</u></p> <p>A. The monitoring office will notify the Comptroller's Office as soon as it is known that a structural change in a recipient will take place.</p> <p>As a means of notification, the monitoring office should route all successor-in-interest agreements or other notification to the Comptroller's Office. If this means of notification is not timely, or sufficient in certain circumstances to precipitate timely audit action, notification should be made by means of a memo or a telephone call.</p>

PROCEDURES AND RESPONSIBILITIES	
AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>I. <u>NOTIFICATION OF COMPTROLLER'S OFFICE</u> (Cont'd)</p> <p>B. The Audit Department will also create and update the following files:</p> <ol style="list-style-type: none"> 1. The Audit Department's Master Recipient Directory. 2. The Audit Department's individual recipient audit folders. 3. The Audit Department's numeric and tickler files. <p>C. The Audit Department will advise the Accounting Department of structural changes in recipients. This notification will be for informational purposes only. The Accounting Department will only rely on information confirmed by the regions or other monitoring offices for the purposes of preparing checks.</p>	<p>I. <u>NOTIFICATION OF COMPTROLLER'S OFFICE</u> (Cont'd)</p> <p>B. N/A</p> <p>C. The monitoring office is responsible for notifying the Accounting Department of any changes in structure that will affect the distribution of monthly checks.</p>
<p>II. <u>NOTIFICATION OF RECIPIENTS</u></p> <p>Upon receipt of notification from the monitoring office, the Audit Department will send a letter to the recipient(s) advising them of LSC's audit and reporting requirements. A copy of the letter will also be sent to the monitoring office. The content of the letter will be based on the type of change in the recipient's structure which has occurred. The purpose of the letter will be to ensure we can accomplish our objectives of:</p> <ul style="list-style-type: none"> - Complete reporting of LSC support, expenditures, assets, liabilities, and fund balances with continuity in reporting periods; - Ensuring surviving entity has the capability to account for and safeguard the funds transferred to it; 	<p>II. <u>NOTIFICATION OF RECIPIENTS</u></p> <p>N/A</p>

PROCEDURES AND RESPONSIBILITIES	
AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>II. <u>NOTIFICATION OF RECIPIENTS</u> (Cont'd)</p> <ul style="list-style-type: none"> - Ensuring that the financial aspects of the successor-in-interest or other agreements were complied with to the extent compliance can be ascertained from review of the applicable audit reports. <p>The content of this letter can vary significantly depending upon the type of structural change that will or has taken place. Each letter will be drafted to fit the particular circumstances. The following represents a list of considerations that should be addressed in drafting the letter.</p> <ol style="list-style-type: none"> 1. Recount the facts of the situation as understood by the Comptroller's Office Audit Department. 2. Confirmation of the date of assumption of operating responsibilities of the terminating recipient(s) by the surviving entity. 3. Confirmation of termination audit reports(s) required and the due dates for those report(s). The due date will be 90 days from termination. 4. Confirmation of the disclosures that should be included in the audit report(s). Disclosures should be sufficient to ensure that the accounting for the structural change is clear. 5. Confirmation of the objective the termination audit report(s) must achieve. 6. Confirmation with respect to the requirement for an initial evaluation of the accounting system and internal controls of the surviving entity, as applicable. 	<p>II. <u>NOTIFICATION OF RECIPIENTS</u> (Cont'd)</p>

PROCEDURES AND RESPONSIBILITIES	
AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>II. NOTIFICATION OF RECIPIENTS (Cont'd)</p> <p>7. Reference to the fiscal responsibilities of the respective boards of directors and program directors in assuring a smooth transition of accountability for support, assets, liabilities, and fund balances.</p> <p>8. Comment on applicability of the supplemental letter for all or some of the termination audit report(s). (Internal controls are no longer relevant for a terminated recipient but questioned costs or other unusual transactions are relevant.)</p> <p>III. FOLLOW-UP</p> <p>Termination audit reports of terminated recipients submitted to the Comptroller's Office will be reviewed by the Audit Department. However, our scope will be limited to:</p> <ol style="list-style-type: none"> 1. Ensuring the correct carry-forward of fund balances from the prior period; 2. Comparing LSC support recognized in the audit report with LSC records; and, 3. Commenting on other items of significance which may require follow-up, especially questioned costs or loss of continuity in accountability for support, expenses, assets, liabilities, or fund balances. <p>IV. DELINQUENT REPORTS</p> <p>A. Delinquent termination audit reports will be included in the monthly delinquency letter.</p>	<p>II. NOTIFICATION OF RECIPIENTS (Cont'd)</p> <p>III. FOLLOW-UP</p> <p>The monitoring office should respond to any audit comments consistent with the circumstances.</p> <p>IV. DELINQUENT REPORTS</p> <p>A. The monitoring office will be responsible for securing delinquent audit reports in accordance with Comptroller's Office Standard Operating Procedures Relating to Recurring Recipient Audits.</p>

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PROCEDURES AND RESPONSIBILITIES	
AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>IV. DELINQUENT REPORTS (Cont'd)</p> <p>B. Delinquent initial evaluations or existing audit reports to be submitted in lieu of initial evaluations will be treated in accordance with Section E, "Delinquent Initial Evaluations" in the Comptroller's Office Standard Operating Procedures Relating to New Recipients.</p>	<p>IV. DELINQUENT REPORTS (Cont'd)</p> <p>B. The monitoring office may implement in coordination with the Comptroller's Office procedures to have LSC make the audit provisions in situations where the monitoring office cannot obtain timely compliance by the recipient. (See Comptroller's Office Standard Operating Procedures Relating to Recurring Recipient Audits.) The monitoring office and Comptroller's Office will be responsible for identifying funds to pay for the required audits.</p>

EXHIBIT V

LEGAL SERVICES CORPORATION

FUNDAMENTAL CRITERIA OF AN
ACCOUNTING AND FINANCIAL REPORTING SYSTEM
FOR LSC RECIPIENTS

LEGAL SERVICES CORPORATION

FUNDAMENTAL CRITERIA

FINANCIAL PHILOSOPHY

<u>Key Elements</u>	<u>Criteria</u>	<u>Aids in Evaluating Criteria</u>	<u>Risks</u>
Financial Planning and Control	Each recipient should formally enunciate a financial philosophy (consistent with its own goals and characteristics) which should govern the overall financial planning and control function of management. It is one of the essential elements needed to adequately manage a legal services program and should be an inherent part of all relevant planning, policy and procedure statements.		
Define Roles and Responsibilities	<p>Specifically:</p> <p>The appropriate roles of the board and management should be defined. The flow of authority and responsibility from the Board to top management and to successively lower levels of management should be identified clearly and communicated to those personnel who need to know.</p>	<p>A Board may use bylaws and resolutions to define and communicate what authority and responsibility it reserves to itself and what is delegated to top management. Similarly, top management should use organization charts, job descriptions, policy statements, and other techniques to define and communicate the authority and responsibilities of lower levels of management and personnel. Plans (goals and priorities and budgets, also are used to define and communicate the objectives) of, and limitations on, individual activities.</p> <p>Merely defining authority and responsibility does not, in and of itself, discharge the responsibility of the financial planning and control function. In addition:</p> <ul style="list-style-type: none">- the definitions must be communicated to personnel who need to know.	<p>Unless authority and responsibilities are defined, an organization may be little more than an undirected group and such a group is unlikely to achieve success in controlling an entity's affairs or achieving its objectives.</p> <p>A failure to communicate can, and probably will, result in transactions, adjustments and journal entries that (1) are not in accordance with management criteria, (2) are not processed or are processed late, or (3) are processed in a careless manner.</p>

FINANCIAL PHILOSOPHY (Continued)

<u>Key Elements</u>	<u>Criteria</u>	<u>Aids in Evaluating Criteria</u>	<u>Risks</u>
Be explicit	Communications of authority should be explicit and, to the extent possible, should be in writing.	<p>techniques must be devised to provide reasonable assurance that the criteria are observed in the day-to-day conduct of the entity's business.</p> <p>Explicit communications of authority are most often found in bylaws, resolutions, policy statements and procedures.</p>	<p>Implicit, unwritten delegations of authority and "understood" criteria all too frequently lead to such exclamations as: "But I thought you understood!", "It should have been obvious!", and "Nobody told me I couldn't do it!".</p>
Establish Financial Controls	Financial controls should be established to safeguard program resources.	<p>The financial authority of supervisory personnel should be clearly defined and evidenced by:</p> <ul style="list-style-type: none"> - Established policies for processing, recording and reporting financial transactions. - Documentation identifying the authority delegated to supervisory and other personnel to initiate and approve financial transactions. - Criteria to be used when modifying or eliminating the above procedures. <p>Numerous other financial controls are discussed in the following pages of the fundamental criteria which help safeguard program resources.</p>	<p>Without adequate controls and definitions of responsibilities:</p> <ul style="list-style-type: none"> - Projects or other major transactions may be initiated that violate management intentions, or legal or grant restrictions. - Resources may be wasted on duplicative efforts or used for unauthorized purposes. - A negative attitude toward internal accounting controls may develop within the entity. ("If top management doesn't care, why should I?")

FINANCIAL PHILOSOPHY (Continued)

<u>Key Elements</u>	<u>Criteria</u>	<u>Aids in Evaluating Criteria</u>	<u>Risks</u>
Translate Goals into Financial Terms	Goals and priorities should be established with the capability to translate them into financial terms which can be used to inspire improvement as well as measure performance.	At a minimum, the translation of goals and priorities into financial terms is represented by a budget.	Without careful planning that relates the goals and priorities to the financial resources available: <ul style="list-style-type: none">- Plans may not be translated into reality.- Training and development of personnel may be misdirected.
Analyze Financial Impact of Decisions	The capability should be established to analyze and assess the financial impact of management decisions both before and after implementation.	Timely and accurate financial management reporting is essential to the analysis necessary in assessing the impact of management decisions such as hiring additional staff, opening new offices, expanding service areas, etc.	Without adequate financial management reports, management may commit the program to activities or services which it simply can not afford. The resulting deficit in operations could seriously curtail activities in the next year or could actually threaten the existence of the program itself.

LEGAL SERVICES CORPORATION

FUNDAMENTAL CRITERIA

ANNUAL FINANCIAL STATEMENTS AND AUDIT REPORTS

<u>Key Elements</u>	<u>Criteria</u>	<u>Aids in Evaluating Criteria</u>	<u>Risks</u>
ANNUAL AUDIT: LSC's Audit Guide	The annual audit of the financial statements should be performed in accordance with LSC's Audit and Accounting Guide for Recipients and Auditors.	Review the annual audit report, the audit review memoranda from the Comptroller's Office, and the memoranda from the regional office.	Without an annual audit in conformity with the LSC audit guide significant audit problems DDS may remain undisclosed to the point where the Board of Directors may not be exercising its stewardship responsibilities.
90-day Reporting	The audit report should be submitted to LSC within 90-days of a recipient's fiscal year-end. Under extraordinary circumstances written extension may be granted by the Regional Director.	Review the recipient's history of timely audit reports.	Consistently delinquent audit reports may indicate a serious problem with financial records or accounting procedures which necessitates extreme efforts on the part of the accounting staff and the auditors to complete the audit. Audit costs may also increase significantly.
Supplemental Letter	The audit report should be accompanied by the auditor's supplemental Letter.	Review the supplemental letter and the corrective action prescribed by the board.	While a recipient may receive a "clean opinion" from the auditor, there are often many areas in which the auditor can make suggestions for improved financial control. The supplemental letter provides the forum for such comments. They may not be materially significant now, but if not corrected, could become significant in the future.
BOARD OF DIRECTORS: Audit Committee	Each recipient's Board of Directors should have an audit and finance committee.		The absence of an audit committee deprives the Board of Directors the use of one of the most effective tools available to assist in the proper discharge of fiduciary responsibilities. In addition, it is not in compliance with a basic recommendation in LSC's Audit and Accounting Guide for recipients and Auditors.

ANNUAL FINANCIAL STATEMENTS AND AUDIT REPORTS (Continued)

<u>Key Elements</u>	<u>Criteria</u>	<u>Aids in Evaluating Criteria</u>	<u>Risks</u>
BOARD OF DIRECTORS (Continued): Approve Auditors	The Board of Directors should approve the appointment of the auditors.		Auditors report to the individual or body that hires them. Management should not be the sole source in control of reporting on the financial performance of its program.
Exit Conference	The Board of Directors Minutes should reflect that the annual Audit Report and auditor's Supplemental Letter were discussed with management and the auditors, and deficiencies, if any, were satisfactorily addressed.	A review of the documentation on the exit conference should include a discussion of significant weaknesses, if any, and corrective action prescribed by the Board.	The failure to have an exit conference with top management and the Board of Directors deprives the auditor of the opportunity to obtain additional information which may have a bearing on the conclusions.
Minutes	The Board of Directors should have policies defining appropriate parameters for fundamental financial decisions. All financial decisions within these parameters should be recorded in the minutes. Appropriate parameters should not include heavy involvement in daily operating decisions by Board members; but should be sufficient to ensure that the financial operations are discharged adequately.	- Minutes should record a clear plan of the levels of authority and responsibility and clear plans of action.	Lack of documentation in the minutes may result in inadequate communication to management. In addition, it will be difficult to later demonstrate that the board had adequately discharged its fiduciary responsibilities.

LEGAL SERVICES CORPORATION

FUNDAMENTAL CRITERIA

BANK ACCOUNTS

<u>Key Elements</u>	<u>Criteria</u>	<u>Aids in Evaluating Criteria</u>	<u>Risks</u>
<u>AUTHORIZATION BY BOARD:</u> Bank Account(s)	Each bank account should be authorized by the recipient's Board of Directors or by the person delegated by the Board. There should be sufficient justification for using more than one bank account. Any account not used should be closed and the bank notified in writing not to process any subsequent transactions. Any remaining bank checks for closed accounts should be destroyed.	Board minutes should reflect Board approval of new bank accounts.	Dormant bank accounts provide greater opportunity for individuals to fraudulently disburse cash and cover the disbursement in the records. An account that is no longer used (zero balance) and is not formally closed can be used to deposit recipient cash receipts and fraudulently disburse them.
Check Signing	All check signers should be designated by the Board of Directors or by the person delegated by the Board. Authorized check signers who were terminated should have their authorizations to sign checks cancelled on the bank(s) records.	Board Minutes should reflect the designation of authorized check signers. A log should be kept of all persons authorized to sign checks. This should be updated as people are added or deleted and the date the bank was notified indicated beside the name.	Checks may be fraudulently issued with signatures that are no longer or never were authorized.
<u>RECONCILIATIONS:</u> Monthly	Bank statements should be reconciled monthly to the general ledger.	A reconciliation procedure should be documented to insure its timeliness and accuracy.	Proper reconciliation procedures will substantially increase the likelihood of irregular disbursements being discovered on a timely basis. It will also reduce the temptation to "borrow" funds with the intent to pay back later. The reconciliation procedure is a fundamental control technique and failure to use it may be interpreted as negligence, especially in an environment where full segregation of duties is not practicable.

BANK ACCOUNTS

<u>Key Elements</u>	<u>Criteria</u>	<u>Aids in Evaluating Criteria</u>	<u>Risks</u>
RECONCILIATION (Continued): Documentation	The reconciliation should be reviewed and approved by a responsible individual and such review appropriately documented.	Examine the monthly bank reconciliation(s). <ul style="list-style-type: none">- Have they been prepared for each bank account?- Is the reconciliation assigned to someone with no bookkeeping duties- Does the person reviewing and approving the reconciliation know how to do it effectively?- Is the review and approval documented on the reconciliation?	Without such a cross-check, errors or irregularities may go unnoticed.
Adjustments	All required adjustments to the general ledger cash balance identified through the reconciliation procedure should be posted promptly. (The adjustment should be posted through the general journal.)	Determine that adjustments to the cash account which have been identified on the reconciliations have been properly posted to the general journal and general ledger.	

LEGAL SERVICES CORPORATION

FUNDAMENTAL CRITERIA

CASH RECEIPTS

<u>Key Elements</u>	<u>Criteria</u>	<u>Aids in Evaluating Criteria</u>	<u>Risks</u>
INITIAL CONTROL: Accountability	Accountability over cash should be established as soon as a cash item is received. It should be assigned to a person with no other bookkeeping duties, whenever possible.	Whenever possible, nonaccounting individuals should be assigned to receive and record cash receipts. This is the most fundamental safeguard in protecting against irregularities.	The major risk in this area occurs when an individual with record keeping responsibilities is also responsible for establishing the initial accountability for cash. Such an individual could cash a check or money order and then adjust the records to cover the irregularities.
Mail	Accountability should begin with the individual opening the mail.	The mail should be opened (whenever possible) by a person with no other bookkeeping duties.	
Endorsement	The checks should be restrictively endorsed by the individual opening the mail.	The endorsement should be stamped on the check.	
Receipts Record	Each receipt should be recorded in a journal or on a listing by the person opening the mail.	The receipt journal should list the amount, and payor for each check.	
Deposit	All receipts should be deposited at least once a week (daily when possible).	Review deposit slips to monitor the frequency of deposits.	Undeposited items risk being lost or misappropriated.
ACCOUNTING RECORDS: Source and Purpose	The accounting records should adequately identify all cash receipts as to source and purpose.	Review the receipts journal to determine that both the source and purpose are clearly identified.	Lack of control over cash means it may go unrecorded and undeposited.
Receipt to Deposit	The records should allow an individual to trace the receipt from initial listing to the deposit in the bank account to the general ledger posting.	Trace several cash receipts from the initial listings through the general ledger. If a reviewer is unable to do this, the system is not adequate.	Inadequate record keeping may allow deposits to go unrecorded in the appropriate ledgers. This produces inaccurate financial statements and management reports.

LEGAL SERVICES CORPORATIONFUNDAMENTAL CRITERIACASH DISBURSEMENTS

<u>Key Elements</u>	<u>Criteria</u>	<u>Aids in Evaluating Criteria</u>	<u>Risks</u>
MANAGING PURCHASES: Purchase Approvals	Approval should be required at an appropriate level of management before a noncancellable commitment can be made.	Criteria for purchases should be documented along with appropriate procedures. For example, all items under \$100 may need one management signature, over \$100 two signatures.	Failure to follow the purchase approval process may result in purchases made without the knowledge of appropriate management or at unacceptable prices or terms.
Invoice and Receipt Verification	An internal verification that goods and services were actually received and the vendor's invoice does not contain errors in pricing, extension, quantities or footing should be performed and documented.	Prenumbered and controlled receiving documents, a receiving log or a receipt verification on the invoice should evidence that goods and services were actually received. Verification procedures to validate vendor numbers, quantities, amounts, etc., should be reviewed.	Without adequate internal verification cash may be disbursed for goods and services not received, in advance of receipt, or in the wrong amount.
Control over Duplicate Payments	Documents should be marked paid or otherwise cancelled to avoid duplicate payment. The check number and pay date should also be noted on the invoice or other supporting documentation.	Procedures for preparation, voiding, safeguarding or otherwise canceling source documentation to prevent reuse (e.g., vouchers, invoices and adjustment forms) should be in operation.	Inadequate document control may result in duplicate payments.
CHECK PREPARATION: Prenumbered	All disbursements (other than petty cash) should be made by prenumbered checks.		Without prenumbered checks cash may be improperly disbursed or recorded.
Authorized Signature	All checks should be signed by an individual(s) authorized by the Board of Directors.		Failure to adhere to the check signing authorizations may result in cash being disbursed without appropriate management knowledge.
Payees	No checks may be made payable to cash or to employees except expense reimbursements and payroll checks. There should be a written prohibition against signing blank checks.		Checks made payable to cash are not adequately identified with the person cashing the check. A check to "cash" is negotiable and therefore does not protect against the improper cashing of a lost or misplaced check.

CASH DISBURSEMENTS (Continued)

Key Elements	Criteria	Aids in Evaluating Criteria	Risks
RECORD KEEPING: Disbursements Journal/Voucher Register	An effective method should be established to initially record and categorize disbursements and then summarize them for recording in the general ledger.	<p>Review the cash disbursements journal or other methods used to initially record checks.</p> <ul style="list-style-type: none"> - Is it organized to allow efficient summarization of natural expenses (travel, rent, etc.); natural expenses by fund, and natural expenses by cost center? - Is it posted to the general ledger on a current basis, i.e. monthly? - Are all checks listed in numerical sequence, including voided checks? - Do the subsidiary records, if any, agree with the postings to the general ledger? 	An ineffective method for initially recording disbursements may adversely affect the ability to accurately report to management on actual expenses.
Disbursement Filing System	An organized method should be established to accumulate and file all documents relating to a particular disbursement for future reference.	Select a sample of disbursement checks and trace them to their source documents. Are the supporting documents accessible in the files?	Improper filing of source documents could result in duplicate payments, or the suspicion of irregularities due to the inability to support disbursements.
Property Record	<p>Purchases of property should result in the preparation of an internal property record. The property record should include:</p> <ul style="list-style-type: none"> - description of the property - date acquired - original cost - funding source - estimated life (depreciation method) - identification number 	Have the property details been added and reconciled to the general ledger control accounts? If so, what were the results?	Failure to maintain adequate property records may result in the inability to fully account for fixed asset purchases, and to support depreciation amounts and property asset balances.
	The property subsidiary record must agree with the general ledger property accounts.		

CASH DISBURSEMENTS (Continued)

Key Elements
GENERAL DISBURSEMENT
TEST

Criteria

Aids in Evaluating Criteria

Risks

Disbursement procedure verification

Review a sample of cash disbursement checks. Include some that appear unusual to you -- large amounts, round dollars amounts, strange vendors, payments to employees, board members, etc.

- Are the checks supported by adequate documentation?
- Is there documentation on the invoice that it was clerically checked?
- Was the item purchased in accordance with standard operating procedures? i.e., is there documentation of who initiated the purchase and who approved it?
- Was evidence of the receipt of goods or services noted?
- Was the invoice cancelled?
- Was it posted to the account to which it was coded in the general ledger, and was the account appropriate?
- Was the supporting documentation accessible in the files?

LEGAL SERVICES CORPORATION

FUNDAMENTAL CRITERIA

PAYROLL

<u>Key Elements</u>	<u>Criteria</u>	<u>Aids in Evaluating Criteria</u>	<u>Risks</u>
RECORDS: Payroll Register	The payroll register should list all employees paid by name, check number, gross pay, withholdings and net pay.	Review the payroll register for content and accuracy. Also, obtain the latest quarterly withholding reports from the Federal and State authorities to determine that they were filed on time and withholding taxes are being paid correctly.	The lack of an adequate payroll register may result in: <ul style="list-style-type: none">- unauthorized amounts withheld from employees- employees paid unauthorized amounts- improper tax withholding Employees may be paid for days not worked.
Attendance Record	An attendance record should be maintained for each employee and should be approved by the employee's supervisor.	.	
Vacation and Sick Leave	A record of vacation, and sick leave time should be maintained for each employee. It should include the time accrued and taken and the available balance.	A review of several employees personnel files will indicate the adequacy of records required for individuals.	Inadequate vacation and overtime compensatory records may result in an employee receiving excessive vacation or in unwarranted wage claims.
Individual Earnings	A record of cumulative individual earnings and withholding amounts should be maintained for each person.	.	Recording every payroll transaction on an individual earnings record will assist in preventing duplicate payments (e.g., computer prepared check followed by a manually prepared check.)
Personnel File	Each employee should have a personnel file which includes documentation concerning appointments, position reclassifications, salary rates and terminations.	To determine if salary changes are properly authorized, examine an employee's file to determine if proper authorizations exist for the pay rate indicated on the payroll register.	Unauthorized adjustments may be processed to increase or decrease amounts paid to one or more employees.

PAYROLL (Continued)

Key Elements
Labor
Distribution

Criteria
A record should be prepared to document the charging of the gross payroll expense to the proper accounts/funds/cost centers.

Aids in Evaluating Criteria
A payroll register will normally always exist at a program. If a deficiency does exist it may be in the documentation of the salary expense distribution. Therefore, the distribution of the gross pay for one pay period should be reviewed.

Risks
Inadequate labor distribution records may result in under or over allocation of payroll costs to funding sources. A funding source audit may then result in disallowed payroll expenses.

- There should be an efficient method for summarizing the charges to the appropriate expense accounts. The distribution should be on a standard journal entry form.

- The distribution record should tie directly to the general ledger accounts.

- The format should accommodate fund and cost center accounting.

CONTROLLING PAYMENTS:
Approvals

Salary and wage rates should be approved by an authorized individual in writing. Procedures must be adequate to provide that employees are paid in accordance with approved wage and salary plans.

Review the wage and salary plan. It should document the following:

- authorized rates or salary ranges by employee group, experience etc.

- frequency of payment

- overtime policies, rates to be paid, etc.

- eligibility for benefits and limits

- benefit costs to be paid by employee

- policies related to employee advances and expense reimbursements

Failure to approve payroll actions or the absence of an appropriate wage and salary plan may result in:

- unauthorized payroll adjustments

- excessive payroll costs

- violation of minimum wage laws, union contracts, etc.

- uncollectable employee advance accounts

PAYROLL (Continued)

<u>Key Elements</u>	<u>Criteria</u>	<u>Aids in Evaluating Criteria</u>	<u>Risks</u>
Adjustments	Any adjustment to payroll disbursements should be approved by an authorized individual independent of payroll preparation.	The wage and salary plan should contain a clear statement of criteria or policy related to payroll adjustments. Controlled standard adjustment forms may be helpful.	Adjustments may be approved that are not acceptable to management.
Check Signing	Payroll checks should be signed by persons having no part in preparing the payroll.	Review the cancelled payroll checks for the prior month and verify that the person signing the checks had no part in the check preparation.	The separation of duties is a fundamental component of adequate internal control. It acts as a deterrent to unauthorized payroll actions.
Imprest Bank Account	Payrolls should be disbursed from an imprest bank account restricted for that purpose.	Verify that there is a separate payroll bank account. Determine the policies surrounding cash deposits, withdrawals and checks written on it. (These policies should be made with respect to the number of employees in the office)	The lack of an imprest payroll account can result in unauthorized use of payroll monies.
Gross to Net to Employee	Employees should be furnished information on their gross earnings, deductions from earnings, etc. with their payroll checks.	The format for furnishing employees their payroll information should include a breakdown for each deduction.	Review of pay stub by individual decreases the possibility for unauthorized deductions and helps insure that a miscalculation or an unauthorized deduction is discovered promptly.
TAX LAW: Quarterly Withholding Report	Proper withholding and prompt payment of applicable Federal, state and local income and payroll taxes should be evidenced by the quarterly withholding reports (Form 941) to the appropriate authorities.	Obtain the latest quarterly withholding reports from the Federal and state authorities to determine that they were filed on time and withholding taxes are being paid correctly.	Laws and governmental regulations may not be complied with when there is a failure to collect and report tax withholdings in a timely and accurate manner.

LEGAL SERVICES CORPORATION

FUNDAMENTAL CRITERIA

GENERAL JOURNAL

<u>Key Elements</u>	<u>Criteria</u>	<u>Aids in Evaluating Criteria</u>	<u>Risks</u>
GENERAL JOURNAL	There should be no direct entries to the general ledger. Every entry to the general ledger not originating from the Cash Receipts Journal, Payroll Register/Labor Distributions, Cash Disbursements Journal or Client Trust Subsidiary Records or any other subsidiary record should initially be posted to the General Journal.	Review the General Journal for the criteria listed.	Posting of entries directly to the general ledger increases the possibility of inappropriate, unauthorized, or unsupported entries.
Documentation	Each entry to the General Journal should be: <ul style="list-style-type: none">- fully described- adequately documented- sequentially numbered- approved by an authorized individual.	Examine the General Ledger to insure that all entries are referenced to where they originated. Examine the supporting documentation for several General Journal entries for several different months. Verify that all entries were approved in writing by the individual assigned that responsibility.	Unsupported or poorly referenced entries are difficult to trace and make it difficult to detect irregularities. Incomplete, inaccurate, or unsupported entries to the general ledger increase the possibility that the financial data may misrepresent the actual financial position.

LEGAL SERVICES CORPORATION

FUNDAMENTAL CRITERIA

CLIENT TRUST ACCOUNTING

<u>Key Elements</u>	<u>Criteria</u>	<u>Aids in Evaluating Criteria</u>	<u>Risks</u>
CLIENT TRUST RECORDS: Individual Balance	Each program should establish a method to determine the balance for each client's accounts.	Review the client trust ledger cards or records to determine that individual client balances are being maintained.	Accurate individual client trust balances as required by standards of professional legal practice are also essential in maintaining client and community relations.
General Ledger Control	The transactions of the client trust accounting system should be under general ledger control.	A recurring weakness, not always immediately obvious, is that although client funds are included in the general ledger, they may not be under general ledger control. Verify that the balance in the general ledger results from recording total receipts from clients and total disbursements for clients made during the month.	The legal profession is held to a high ethical standard of accountability when client funds are involved. Defaults, even if amounts involved are not material, with respect to the standard of accountability may subject the responsible attorney and the Project Director to review by the local or state Bar.
Reconciliation	The total of the individual client funds held should be reconciled to the general ledger bank account balance and general ledger liability balance on a monthly basis.	Examine a monthly bank reconciliation: <ul style="list-style-type: none">- Determine that the individual client ledger cards have been added and agree with the bank reconciliation.- Trace the bank balance to the bank statement and book balance to the general ledger for one month.- Determine that journal entries make adjusting entries are properly supported.- If the latest reconciliation has reconciling items that have been outstanding for over two months determine how the items will ultimately be disposed of.	Delinquent or inaccurate reconciliation represents a lack of adequate control over financial transactions and increases the possibility that irregular transactions will be undetected, or accountability for client funds will be lost.

CLIENT TRUST ACCOUNTING (Continued)

<u>Key Elements</u>	<u>Criteria</u>	<u>Aids in Evaluating Criteria</u>	<u>Risks</u>
DISBURSEMENTS: Separate Bank Account	A separate bank account should be maintained only for client funds. The controls over this account should be as specific and clearly stated as the controls established for the program's regular bank account. Client funds may not be commingled with any other funds.	Verify that a separate bank account is being used and that the criteria and policies concerning its use are documented.	The high volume of client trust cash transactions increases the risk that client funds may be diverted. Standards of the legal profession normally prohibit the commingling of client funds.
Prenumbered Checks	Prenumbered checks should be used for disbursements. All check numbers should be accounted for.	Review the disbursement register for proper recording of all check numbers.	The absence of prenumbered checks can result in the loss of control over the checking account. Checks can be written and not recorded.
Adequate Documentation	Documentation supporting the reason for each disbursement should be retained in the files.	The source documents for cash disbursements should be the voucher copies of the check or the client trust cash disbursement book. Each client disbursement should be supported by a request from the case attorney or other documentation that substantiates the propriety of the disbursement.	Inadequate documentation and approval can result in unauthorized disbursements.
RECEIPTS: Duplicate, Prenumbered	Prenumbered receipts should be issued for all money received from clients. Accountability in the form of duplicate copies of the receipts issued should be maintained.	The source documents for receipts should be the prenumbered client receipts. Specific people should be designated to issue receipts. Clients should be advised of the individual who can receive cash (perhaps by a sign in the office which could include a sample of the receipt they should request). There should also be documented procedures for receiving cash in and out of the office.	Money received may not be recorded if the cash receipts are not prenumbered.

LEGAL SERVICES CORPORATION

FUNDAMENTAL CRITERIA

GENERAL LEDGER

<u>Key Elements</u>	<u>Criteria</u>	<u>Aids in Evaluating Criteria</u>	<u>Risks</u>
PROCEDURES: Monthly	The general ledger should be posted monthly and on a timely basis.	Verify that there is a detailed closing schedule showing due dates and the individuals responsible for various categories of journal entries.	Timely management reports are dependent upon a timely closing and reconciliation of errors. The failure to close promptly can also allow errors and omissions to go undetected for long periods of time or never be detected.
Double-Entry Method	The general ledger should be maintained on a double-entry basis.	During the general ledger review determine that a double entry method is being used, and that all entries are made in ink.	Inadequate maintenance of the general ledger may weaken control over overall operations. Audit costs may also increase significantly.
DESIGN: Fund Accounting/ Cost Center Accounting	<p>The general ledger design should accommodate fund accounting and/or cost center accounting and requirements in accordance with the most expedient procedures in the circumstances.</p> <p>Cost center or fund accounting requirements (whichever is not incorporated into the general ledger) may be provided for outside of the confines of the general ledger.</p>	Determine whether the general ledger any subsystems are efficiently designed to accommodate fund accounting and cost center reporting.	The reliability of management reports generated from sources other than the general ledger can be significantly impaired and the actual report preparation significantly more cumbersome.
CHART OF ACCOUNTS: Chart of Accounts	The chart of accounts should be adequate to provide general ledger detail sufficient to easily generate needed management information.	<p>Review the chart of accounts. It should be:</p> <ul style="list-style-type: none">- documented with all valid accounts listed and- adequately detailed to provide needed management information. <p>Procedures should also be established for requesting and approving changes in the chart of accounts.</p>	A chart of accounts which lacks adequate detail can significantly increase the time necessary to research a particular situation or obscure the situation completely.

LEGAL CIVIL CORPORATION
FUNDAMENTAL CRITERIA

TRIAL BALANCE

<u>Key Elements</u>	<u>Criteria</u>	<u>Aids in Evaluating Criteria</u>	<u>Risks</u>
CONTROL ELEMENT: Monthly	A trial balance of the general ledger should be prepared monthly.	Verify that a trial balance was prepared for each month.	Without a monthly trial balance, there is no assurance that the double entry system is working effectively.
In balance	Any out of balance condition should be identified and corrected.	Perform a detailed review of one trial balance and answer the following questions: - Was it in balance? - Did it agree with the general ledger accounts? (Test one month by tracing some of the balances to the general ledger) - Was an adding machine tape retained in the files to document that the trial balance footed?	If the books are not balanced - Errors or omissions may go undetected. - The financial position may be erroneously presented. - Management reports may be inaccurate, therefore resulting in erroneous decisions.
Format	The trial balance should facilitate the preparation of management reports.	During the previous review also answer the following questions on format: - Did the trial balance contain all of the accounts in the chart of accounts even though there may have been zero balances in the general ledger? This is most applicable if the trial balance is utilized to generate reports in lieu of the general ledger. - Was the trial balance (or the general ledger) designed so that all required reports could be drawn from it without need to refer to other records or perform other analyses for actual amounts?	Increased time and effort may be spent on the preparation of management reports.

TRIAL BALANCE (Continued)

<u>Key Elements</u>	<u>Criteria</u>	<u>Aids in Evaluating Criteria</u>	<u>Risks</u>
Kept on File	All trial balances should be kept on file until the audit for that fiscal year has been completed and the audit report issued.	Verify that responsibility for the file maintenance has been assigned.	Audit costs may increase.

LEGAL SERVICES CORPORATION

FUNDAMENTAL CRITERIA

MANAGEMENT REPORTS, BUDGETS AND PROJECTIONS

<u>Key Elements</u>	<u>Criteria</u>	<u>Aids in Evaluating Criteria</u>	<u>Risks</u>
USE OF REPORTS: Timeliness	The director should receive a monthly management report within a prescribed number of days after month-end.	Policies, procedures and responsibilities for all report preparation should be determined and documented. A time estimate should also be identified which is reasonable under the circumstances. Verify that the reports were completed each month and on a timely basis.	Significantly delayed management reporting does not reflect the current financial condition. The organization may be spending in excess of expected support and revenues. There is no budgetary control without timely reporting. Management and the Board of Directors may make budgetary or financial decisions having significant financial impact without the benefit of relevant financial information, or based upon erroneous information.
Program Director Review and Approval	The director should use the monthly management reports to insure that all program resources are fully, efficiently and effectively used.	Discuss with the program director his or her use of the reports and document the results of the discussions.	Irregularities that may be revealed through the review of cost center reports may disclose improper transactions which might otherwise go unnoticed. For example, a negative variance in a salary budget category may reveal that individuals are being paid in excess of authorized amounts.
TYPE OF REPORTS: Total Program Budget vs. Actual	A cumulative comparison of total actual expenses against total budgeted expenses should be prepared. Variance both over and under should be identified on the face of the report.	By reviewing the monthly management reports evaluate whether: <ul style="list-style-type: none">- The reports are informative enough to be meaningful to management (i.e., large expenses are not buried in very broad expense accounts).- They contained the information as described for comparison of totals against budget, etc.	Monthly review of the reports may also disclose conditions which are the result of bookkeeping errors. The absence of budget versus actual reports could hide potential budgetary problems which could, for example, necessitate decreased spending.

MANAGEMENT REPORTS, BUDGETS AND PROJECTIONS (Continued)

Key Elements	Criteria	Aids in Evaluating Criteria	Risks
<p>TYPE OF REPORTS (Continued):</p> <p>Funding Source Budget vs. Actual</p>	<p>Special reports by funding source designed to meet grantor and internal reporting requirements should be prepared as required.</p>	<p>The review above should also verify that all grantor reporting requirements were met (for example, reporting by fund).</p>	<p>The failure to comply with funding source requirements can result in a reduction or loss of funding.</p>
<p>*Cost Center Budget vs. Actual</p>	<p>The monthly reporting package should be designed to facilitate cost center reporting. Both budgeted expenses and actual expenses should be identified on each report. (Capabilities to account for costs by program can evolve from cost center accounting.)</p>	<p>Determine if cost center reporting is being used and that all cost center requirements for management and grant reporting purposes are being met. If cost center reporting is not being used in a multi-location environment, document management's reasons and alternate procedures to maintain cost center control.</p>	<p>A consolidated report lacks the detail necessary for proper analysis and control of cost center spending.</p>
<p>REPORT PREPARATION: Financial System Design</p>	<p>The accounting and financial reporting system to initially record, categorize, and summarize financial transactions at the trial balance and general ledger level and below should be designed to facilitate management report preparation.</p>	<p>A potential conflict may exist between a recipient's need for financial reports and the region's need for financial reports. Almost without exception, the requirement for a "standard report" will generate much clerical work for a recipient unless the recipient has specifically designed its accounting and reporting system to accommodate both the region and its own reporting needs. In many cases the highly summarized "standard reports" which may be useful to the regions may not be useful as the recipient's management reports. Determine if the system is designed to be flexible enough to meet the region's and other funding source requirements.</p>	<p>The preparation of management and funding source reporting may be more costly when the financial system is poorly designed. However, regardless of the system design, the preparation of a report should be reviewed periodically to determine that the benefit derived from the report is greater than the cost of preparing it.</p>

* Optional unless the information is required to satisfy grant conditions or management needs.

MANAGEMENT REPORTS, BUDGETS AND PROJECTIONS (Continued)

<u>Key Elements</u>	<u>Criteria</u>	<u>Aids in Evaluating Criteria</u>	<u>Risks</u>
REPORT PREPARATION (Continued): Detail Available	The monthly management report should be sufficiently detailed to be useful in managing the program's expenses.	If detailed analysis of expense accounts is required to determine the reason for a significant over-expenditure of a budget category, the report may be too highly summarized.	Reports may not fairly present what they purport to display.
Commitments	The available program, fund or cost center balance should be adjusted for any known commitments that would have a material effect on the amounts reflected in the report.	Review management reports for a commitments column or a notation that actual expenses have been adjusted for known commitments. Determine the procedures and support for making such adjustments.	The failure to identify major nonrecurring commitments on behalf of a program may result in the appearance of being under budget when in fact the payment of the program commitment would cause the program to be over budget.
Allocations	Common expenses should be allocated in a fair, consistent and equitable manner to the individual cost centers, funds and programs.	The allocation methodology should be reviewed and assessed as to whether it fairly represents the total cost of a program.	The allocation of costs to programs is especially important to demonstrate the total cost of a program that a funding source is financing.

MANAGEMENT REPORTS, BUDGETS & PROJECTIONS (Continued)

<u>Key Elements</u>	<u>Criteria</u>	<u>Aids in Evaluating Criteria</u>	<u>Risks</u>
BUDGETING: Process	The budgeting process should be organized, should involve top management, and should be closely tied to the goals and priority setting process.	An overall evaluation of the budgeting area will require a review of the budget "process" as it relates to each of the criteria listed. The questions which should be answered include the following: - Did the budgeting process appear organized and effective?	Budgeting and projecting are the key tools that should be utilized by management to adequately control and plan the financial resources of the program.
All Expected Resources	The budget included in the monthly management reports should include all funds expected to be available to the recipient during its fiscal year.	- Does the budget include carry-over funds or carry-over deficits? - Does the total "budget" or management report reflect funds expected to be received from all sources based upon the best information available?	
From Cost Centers	The budget should be built from cost centers and "rolled-up" to create the total budget.	- Does the budget process and the accounting records accommodate preparing a budget by cost center, or does the recipient attempt to prepare a budget on a total program basis?	
Assumptions	Schedules should be available to document the assumptions made in arriving at the final cost center budgets.	- What do the detailed schedules that were used to develop the budget contain? - Are the budget amounts and assumptions used adequately documented and supported in the detailed schedules?	
Allocation	The budget should be allocated by sources of funds within cost centers by the most expedient and equitable means available.	- Are costs equitably allocated by source of funds within cost centers?	

MANAGEMENT REPORTS, BUDGETS AND PROJECTIONS (Continued)

<u>Key Elements</u>	<u>Criteria</u>	<u>Aids in Evaluating Criteria</u>	<u>Risks</u>
BUDGETING (Continued): Format	The budget should be formatted to coincide with the format of the management reports. In addition, for budgeting purposes the chart of accounts should be sufficiently detailed to avoid extensive references to other sources of information or reclassification to determine the content of an account for budgeting or other management purposes.	- is the chart of accounts detailed enough to facilitate the budgeting process or does preparing a meaningful budget require extensive analysis of the accounts and reference to many other records?	

LEGAL SERVICES CORPORATION

FUNDAMENTAL CRITERIA

MANAGEMENT REPORTS, BUDGETS AND PROJECTIONS (Continued)

<u>Key Elements</u>	<u>Criteria</u>	<u>Aids in Evaluating Criteria</u>	<u>Risks</u>
PROJECTING		A projection is simply rebudgeting at a later time or when more information is known. The process for projections and budgeting are the same. Review the program budget projections to answer the following questions:	
Quarterly	The monthly management reports should incorporate a comparison of expended budget against projected expenditures at least quarterly during the fiscal year.	<ul style="list-style-type: none"> - Are projections prepared on a quarterly basis? - If any of the management reports reveal a large variation from budget -- is there any evidence that management has recognized and is taking the necessary steps to resolve the potential problem? 	Infrequent projections can weaken control over spending and result in budgetary problems.
Built from Cost Centers	The projections should be built from cost centers with adequate input from the cost center manager.	<ul style="list-style-type: none"> - Are the projections built from cost centers? 	Projections made centrally without adequate input from the cost center manager may result in incomplete information and a distortion of the projected financial condition of the program.
Assumptions	The projections should be supported by schedules that document the assumptions used to arrive at the projected amount.	<ul style="list-style-type: none"> - Are projections supported? If so, trace several projected amounts back to the original schedules. 	Inadequate support for assumptions increases the possibility of errors. It also makes future analysis and improvement of projection techniques difficult.
Format	<p>Projection reports should include the following for each line item:</p> <ul style="list-style-type: none"> - Total budget - Actual Expenditure to date - Unexpended budget - Projected Expense remaining - Projected total (over) under budget. 	<ul style="list-style-type: none"> - Are projection reports easy to understand. 	

LEGAL SERVICES CORPORATION

FUNDAMENTAL CRITERIA

GENERAL

<u>Key Elements</u>	<u>Criteria</u>	<u>Aids in Evaluating Criteria</u>	<u>Risks</u>
ASSIGNED RESPONSIBILITY	The individual responsible for the timeliness and accuracy of each report, ledger, journal, procedure and form should be documented in the recipient's procedures.	Verify that there is a clear documentation of responsibilities for every major area covered in the fundamental criteria.	Unclear definition of duties often results in increased errors, a reduction of individual accountability and in reports not being prepared on a timely basis.

EXHIBIT VI



LEGAL SERVICES CORPORATION

AUDIT AND ACCOUNTING GUIDE
FOR
RECIPIENTS AND AUDITORS

Revised September 1979

Prepared with the assistance of Arthur Andersen & Co.



LEGAL SERVICES CORPORATION
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FOREWORD

Under the Legal Services Corporation Act the Corporation provides financial support to organizations that furnish legal assistance to eligible clients.

The Act requires that recipients of financial support provide for an annual audit. This Guide has been prepared for use by recipients and independent certified public accountants or other auditors who perform such audits.

Cordially,

Thomas Ehrlich
President

Thomas Ehrlich
President
E. Clinton Bamberger, Jr.
Past Vice President
DIRECTORS
Robert C. Cranton, Chairman
Ithaca, New York
Marshall J. Rieger
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CHAPTER 1 - INTRODUCTION1-1 DEFINITIONS

The following terms are used throughout this Guide and are defined as follows.

- Act - Public Law 93-355 ("Legal Services Corporation Act") enacted by Congress July 25, 1974, establishing Legal Services Corporation.
- AICPA - American Institute of Certified Public Accountants, the professional organization of CPA's that promulgates standards which members of the profession must follow.
- Annual Financial Statements - Recipient's annual financial statements including a Balance Sheet, Statement of Support, Revenue and Expenses and Changes in Fund Balances, the accompanying footnotes, and any other statements the recipient and auditor determine are necessary to make the financial statements not misleading.
- Generally Accepted Accounting Principles (GAAP) - Accounting principles which have substantial authoritative support as evidenced through the approval by the Financial Accounting Standards Board, the American Institute of Certified Public Accountants or accepted industry practice.
- Guide - This Audit and Accounting Guide for Recipients and Auditors issued by Legal Services Corporation in August 1976, revised June 1977.
- LSC - Legal Services Corporation.
- Program - The total activities of an organization, regardless of how those activities are funded.
- Recipient - Any entity receiving financial assistance from Legal Services Corporation through grants or contracts.
- Supplemental Letter - Letter from the recipient's auditor to its board of directors commenting on internal controls and grant/contract compliance and other significant matters. This letter is to be submitted to Legal Services Corporation under separate cover, along with the annual financial statements.

1-2 PURPOSE

The purpose of this Guide is to assist recipients and their auditors in understanding the accounting, reporting, and auditing requirements for contracts and grants entered into with LSC. The Guide describes the accounting policies, records, and internal control procedures considered adequate to provide proper accounting, reporting, and financial management of a recipient's program. Another purpose of the Guide is to provide standard financial reporting formats to help achieve uniformity among the many recipients having similar organizations.

The requirements and suggestions in this Guide represent items LSC believes are necessary for the LSC legal assistance program to demonstrate effective and responsible financial management at both the local and national levels.

1-3 BACKGROUND

Prior to October 13, 1975, the Federal Government provided legal assistance to individuals through the Community Services Administration and, prior thereto, through the Office of Economic Opportunity. On July 25, 1974, Congress passed the "Legal Services Corporation Act of 1974" to establish a private, nonmembership, nonprofit corporation to administer the legal assistance program. The Act established an eleven-member Board of Directors nominated by the President of the United States and confirmed by the Senate to direct LSC. A majority of the Board must be members of the bar of the highest court of the state in which the member is licensed, and no member can be a full-time employee of the United States. Board members' terms are three years and cannot be renewed.

LSC was authorized by the Act to provide financial assistance to qualified organizations which furnish legal assistance to "eligible clients,"

as defined by LSC. LSC is empowered to make grants to, and contract with individuals, partnerships, firms, corporations, nonprofit organizations and, upon special determination by the Board of Directors that such services will not be adequately provided through nongovernmental arrangements, with state and local governments.

1-4 AUTHORITY

LSC has prepared this Guide to establish accounting and reporting requirements for recipients of financial assistance under the authority provided by the following sections of the Act:

Records and Reports - Section 1008:

"(a) The Corporation [LSC.] is authorized to require such reports as it deems necessary from any grantee, contractor, or person or entity receiving financial assistance under this title regarding activities carried out pursuant to this title."

"(b) The Corporation is authorized to prescribe the keeping of records with respect to funds provided by grant or contract and shall have access to such records at all reasonable times for the purpose of insuring compliance with the grant or contract or the terms and conditions upon which financial assistance was provided."

Audit - Section 1009(c)(1):

"The Corporation shall conduct or require each grantee, contractor, or person or entity receiving financial assistance under this title to provide for an annual financial audit. The report of each such audit shall be maintained for a period of at least five years at the principal office of the Corporation."

Recipients' Non-LSC Funds - Section 1010(c):

"Non-Federal funds received by the Corporation, and funds received by any recipient from a source other than the Corporation, shall be accounted for and reported as receipts and disbursements separate and distinct from Federal funds...."

1-5 FINANCIAL RESPONSIBILITIES OF RECIPIENTS AND APPOINTMENT OF AUDITORS

Recipients, under the direction of their board of directors, are required to establish and maintain adequate accounting records and internal

control procedures. Recipients are also responsible for preparing annual financial statements and arranging for an examination of those statements to be completed within 90 days of their fiscal year-end. The examination may be conducted by auditors employed by Federal, state, or local governmental units or by public accountants. Where public accountants are engaged, they must be either independent certified public accountants or independent licensed public accountants -- licensed on or before December 31, 1970. Public accountants must be certified or licensed by a regulatory authority of a state or other political subdivision of the United States.

Recipients shall not select any auditor to conduct an examination who is not in fact independent, as defined in Section 220 of the American Institute of Certified Public Accountants' "Statement on Auditing Standards No. 1." That pronouncement states in part that "...to be recognized as independent, he [the auditor] must be free from any obligation to or interest in the client, its management, or its owners."

It is imperative that there is a clear understanding between the recipient and the auditor with respect to the scope of the auditor's services and the nature of his responsibility. The Guide illustrates an auditor's contract, as a method to communicate the arrangement, but a letter from the auditor is acceptable if all appropriate subjects are contained therein. The program director and board of directors should review the arrangement closely to avoid any potential misunderstandings. The board of directors has the final responsibility for appointment of the auditor, although LSC reserves the right to preclude the appointment of an auditor if experience has shown the auditor's work to be unsatisfactory or if a conflict of interest exists.

1-6 RESPONSIBILITIES AND QUALIFICATIONS OF AUDITORS

The examination of the recipient's annual financial statements is to be conducted in accordance with generally accepted auditing standards. While Chapter 6 of this Guide discusses various auditing items, it is not intended to be an audit program nor to supplant the auditor's professional judgment as to the work required to meet generally accepted auditing standards.

In addition to the examination of the recipient's financial statements, the auditor is required to submit a supplemental letter to the board of directors and LSC commenting on items noted during the examination with respect to: (a) needed improvements in internal controls, (b) significant and unusual transactions, (c) compliance with the Guide, (d) compliance with the financial or accounting provisions of the grant or contract, (e) eligible costs, and (f) the status of the comments from the previous year's supplemental letter.

While the auditor will contract directly with the recipient for audit services, it is emphasized that any items considered by the auditor to justify reporting to the recipient's program director and/or board of directors, should also be included in the supplemental letter for LSC's consideration. If such items are of a serious nature and relate to the recipient's capabilities to safeguard and account for LSC funds, the facts and circumstances must be brought to the attention of LSC's Comptroller immediately. This requirement exists for items coming to the attention of the auditor during the course of his annual examination or during the course of any other work performed by the auditor during the year. LSC believes that failure to comply with this request is justification for exercising its veto authority in the selection of auditors for future audit engagements.

1-7 FULL FINANCIAL DISCLOSURE

LSC requires that recipient's financial statements be prepared in accordance with this Guide and include the entire financial resources of the program including all non-LSC funds. The provision for full financial disclosure allows LSC to evaluate the total legal assistance effort being provided by recipients throughout the United States. It also assists the recipient's board of directors in their responsibility to see that meaningful financial statements are prepared and that they are made available to all interested persons.

In connection with this requirement, every effort should be made to satisfy the needs of all funding organizations with one annual audit report. It is the responsibility of the recipient's program director to arrange for a single audit acceptable to all funding sources. LSC recognizes that this objective may not be possible in some cases. When a single audit is not acceptable to all funding sources, the recipient must contact the Audit Manager in the Comptroller's Office of LSC to arrange an acceptable alternative.

LSC intends to fund each recipient annually. The fiscal year-end of the recipient should be based upon the optimal report date for the recipient and the majority of the recipient's funding sources. The fiscal year-end should not be determined solely by LSC's funding period. In most instances, it will be convenient for programs to select a fiscal year ending on a calendar quarter (i.e., March 31, June 30, September 30, or December 31), although a fiscal year ending in any month will be acceptable to LSC. LSC requires each recipient's board of directors to establish an audit/finance committee to provide overall financial guidance, review the annual financial reports, and institute any changes necessary to insure proper administration and control of funds.

CONTINUED

3 OF 5

LEGAL SERVICES CORPORATION
STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED SEPTEMBER 30, 1980
WITH COMPARATIVE TOTALS FOR 1979

	Program Activities	Supporting Activities	Total Expenses	
			1980	1979
Salaries and benefits	\$ 4,407,238	\$2,207,490	\$ 6,614,728	\$ 5,604,407
Consulting	2,422,678	474,734	2,897,412	3,534,177
Travel	2,499,908	344,759	2,844,667	3,317,780
Rent and communications	682,412	892,960	1,575,372	1,311,106
Materials and supplies	254,640	194,216	448,856	366,908
Printing and reproduction	454,334	228,304	682,638	568,750
Other services	872,666	463,303	1,335,969	1,230,841
Total	11,593,876	4,005,766	16,399,642	15,933,969
Donated services	74,123		74,123	79,527
Depreciation, amortization and retirements	54,273	131,225	185,498	165,072
Total	11,722,272	4,936,991	16,659,263	16,178,568
Grants and contracts	291,069,685	92,050	291,161,735	250,520,031
Total expenses	\$302,791,957	\$5,029,041	\$307,820,998	\$266,698,599

(See Notes to Financial Statements)

LEGAL SERVICES CORPORATION
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 1980 AND 1979

Note 1 - Nature of the Corporation

Legal Services Corporation is a private non-membership, non-profit Corporation, established by Congress in the Legal Services Corporation Act of 1974, Public Law 93-355, and amended by Public Law 95-222. The purpose of the Corporation is to provide financial support to independent organizations that provide legal assistance in non-criminal proceedings or matters to persons financially unable to afford legal assistance.

The Corporation is not a private foundation, and it is exempt from Federal income taxes under Section 501(c)(3) of the Internal Revenue Code.

Note 2 - Summary of Significant Accounting Policies

Basis of Accounting

The Corporation records support, revenue and expenses in conformity with the accrual basis of accounting.

Support

Legal Services Corporation is funded primarily through appropriations from Congress. The appropriations are recognized as support in the period designated by Congress. After payment to the Corporation, all funds remain available until expended. Grants from other organizations are recognized as support in the period the award document is signed.

Grants and Contracts

Liabilities and expenses related to grants and contracts are recognized when the awarding document is signed.

Properties

The acquisition cost of office furniture and equipment is capitalized and depreciated by the straight-line method over an estimated useful life of ten years. Leasehold improvements are capitalized at cost and amortized by the straight-line method over the life of the lease. For fiscal years 1980 and 1979, depreciation and amortization expenses are \$184,352 and \$164,272, respectively.

Donated Services

Donated services represent the value of services contributed to the Corporation. The value of these services is the difference between the fee normally charged by the donors rendering the services and the pro bono publico rate charged to the Corporation.

Note 3 - Retirement Plan

The officers and employees of the Corporation are included in the Federal Civil Service Retirement System, although they are not officers and employees of the Federal Government. The Corporation makes contributions for this retirement benefit at the same rate applicable to agencies of the Federal Government. The Corporation's contributions included in the accompanying financial statements for fiscal years 1980 and 1979 are \$405,856 and \$340,564, respectively.

The Corporation, since its inception, has participated in this retirement system, and accordingly, has no obligation for past service costs.

Note 4 - Lease Agreements

The Corporation has entered into several long-term leases for office space for its headquarters and regional offices which expire at various dates through 1986. The maximum aggregate amount due in any one year under existing lease agreements approximates \$722,430. Rent expense for fiscal years 1980 and 1979 is \$760,272 and \$652,148, respectively.

Note 5 - Fund Balances

The fund balances at September 30, 1980 have been designated as follows:

	<u>Federal Appropriation</u>	<u>General</u>
Field program operations	\$9,273,788	
Recruitment of attorneys for field programs (Reginald Heber Smith Program)	249,728	
Quality improvement program, educational loan repayment program and private bar participation		\$1,112,715
Future grants and contracts and other legal service activities	<u>34,750</u>	<u>1,480,343</u>
Total	<u>\$9,558,266</u>	<u>\$2,593,058</u>

On November 19, 1980, negotiations relevant to the grants and contracts for the various fund balance designations were not complete. Furthermore, budget commitments are subject to continual review by management and may be increased or reduced at any time.

Note 6 - Federal Appropriations

During fiscal year 1977, the Federal appropriation was paid by the U.S. Department of Treasury to the Corporation in one installment at the beginning of the fiscal year. During that year, cash not immediately needed for operations was invested in securities guaranteed by the U.S. Government or any agency thereof. The interest from these investments has been included in the General Fund in the accompanying financial statements. In each subsequent fiscal year, the Corporation's Federal appropriation was withdrawn from the U.S. Department of Treasury on an as-needed basis. The undisbursed portion of the Federal appropriation is reflected in the accompanying financial statements.

Since October 1, 1980 the Corporation has been operating under a Continuing Resolution (P.L. 96-369) which authorizes the same level of activity authorized in the Act of Appropriation for the fiscal year 1980.

APPENDIX 1(D)(2)

Legislation and National Security Subcommittee
B-373 Rayburn House Office Building
Washington, D.C. 20515

February 19, 1981

Honorable William F. McCalpin
Chairman
Legal Services Corporation
Washington, D.C. 20005

Dear Mr. Chairman:

Enclosed for your review and comment is the General Accounting Office report entitled, "Disappointing Progress in Improving Systems for Resolving Billions in Audit Findings".

The report is a result of this Subcommittee's continued effort to determine whether departments and agencies have in place audit follow-up and resolution systems that meet the recommendations made by the Committee on Government Operations and the General Accounting Office, as well as the revised guidelines of the Office of Management and Budget.

The report shows that while progress has been made by some of the departments and agencies, the absence of effective audit follow-up and resolution systems is still a very serious problem. I am very concerned that the amount of unresolved audit findings has actually increased since the Committee report was issued in 1979.

The Committee would appreciate your comments regarding the reasons for any deficiencies found by GAO in your system, as well as the actions you are taking to comply with OMB guidelines.

I hope that we can receive your comments before March 31, 1981. Your cooperation and immediate attention in reviewing and commenting on this report would be sincerely appreciated. I look forward to your response.

With best wishes, I am

Sincerely yours,

JACK BROOKS
Chairman

Enclosure

APPENDIX 1(D)(2)(a)

OFFICE OF MANAGEMENT AND BUDGET

[Circular No. A-73; Revised Transmittal Memorandum No. 1]

Audit of Federal Operations and Programs
November 27, 1979.

This Transmittal Memorandum revises OMB Circular A-73, "Audit of Federal Operations and Programs," by replacing paragraph 7.h. with a new paragraph 8 (attached).

The revision requires semiannual reports to the head of an agency, procedures for resolving major disagreements between audit and program offices, a maximum of six months to determine agency action on audit recommendations, and a requirement for periodic evaluations of an agency's system.

James T. McIntyre, Jr.,
Director.

Circular A-73, "Audit of Federal Operations and Programs"

Circular A-73 is revised by replacing paragraph 7.h. with a new paragraph 8. Other paragraphs are renumbered accordingly.

a. Followup. Each agency will establish policies for prompt and proper resolution of audit recommendations. Timely action on recommendations by responsible management officials is an integral part of an agency audit system, and is the key to its effectiveness.

b. Agency followup systems must provide for a complete record of action taken on audit findings and associated disallowed, suspended, or questioned costs. Such systems must provide for the following:

(1) Designate officials responsible for audit followup.

(2) Maintain accurate records of all audit reports or significant findings until final resolution. Records will be maintained to insure appropriate accounting and collection controls over amounts determined to be due the Government.

(3) Make written determinations promptly on all audit findings, and initiate action to assure that these determinations are carried out. Such determinations shall be made within a maximum of six months after issuance of the report. Final resolution should proceed as rapidly as possible.

(4) Assure that resolution actions are consistent with law and regulation, including written justification and the legal basis for decisions not to seek recovery of amounts due as a result of audit reports.

(5) Forward to the head of the agency or to a designee for resolution, all major disagreements between the audit office

and officials responsible for acting on recommendations, and all reports or recommendations on which responsible officials have failed to provide a written determination within six months.

(6) Provide semiannual reports to the agency head on the status of all audit reports over six months old, the number of reports or findings resolved during the period, collections, or offsets made, and demands for payment made.

(7) Provide for an evaluation of whether the audit followup system is adequate and results in timely and proper resolution of audit findings and recommendations. The first evaluation will be made within one year of implementation of the system, and evaluations will be made every two years thereafter.

c. When audit recommendations requiring corrective action involve more than one program, agency, or level of government, the agency making the audit must coordinate its corrective action with that of other affected organizations."

Circular A-73, "Audit of Federal Operations and Programs"

AGENCY: Office of Management and Budget.

ACTION: Final Policy.

SUMMARY: This notice advises that OMB Circular A-73 has been revised by replacing paragraph 7.h. with a new paragraph 8. Previously, Circular A-73 provided that agencies were to have adequate followup systems for resolving audit recommendations and findings. Based upon our assessment of agency's followup systems, including recommendations in a CAO report on this matter, and subsequent Congressional hearings, we are specifying in the Circular the key elements each agency's system must contain.

The revision requires semiannual reports to the head of an agency, procedures for resolving major disagreements between audit and program offices, a maximum of six months to determine agency action on audit recommendations, and a requirement for periodic evaluations of an agency's system.

EFFECTIVE DATE: This revision becomes effective upon issuance.

FOR FURTHER INFORMATION CONTACT: John J. Lordan, Chief, Financial Management Branch, Office of Management and Budget, Washington, D.C. 20503 (202) 395-6223.

SUPPLEMENTARY INFORMATION: On July 10, 1979, a notice was published in the Federal Register (44 FR 40481) to amend Circular A-73. Interested persons were invited to submit written comments by August 10, 1979. About 15 comments were received from Federal and State agencies. The comments were considered in developing these final

regulations. Although all commenters agreed with our objective of strengthening agency followup systems, some raised questions or made suggestions for clarifying changes. The more significant comments received, and OMB's responses to them are discussed below.

Changes in Final Regulation:

Set forth below are changes that have been adopted in the final regulations. The paragraphs are keyed to the proposed regulations published on July 10, 1979.

1. Subparagraph (2) has been amended to clarify that records must be kept on audit recommendations until they are resolved.

2. Subparagraph (3) was revised to make it clear that resolution of audit findings should be accomplished as quickly as possible.

3. Subparagraph (4). A clause was added to make it clear that the legal basis for decisions not to seek recovery of amounts determined to be due the Government must be included in the written justification for such decision.

Suggested Changes Not Considered Necessary:

Comment: One commenter pointed out that reports on proposal evaluations may contain opinions on contractor estimates of future costs which are not true "questioned costs." As such, they need not be included in the same system of records that accounts for questioned incurred costs.

Response: We agree the inclusion of these costs would be misleading. However, these reports are subject to most of the other elements of the audit followup system. Specifically, they must be recorded as open reports until a written determination is made, and they are subject to top management review as provided in paragraph 8.b(5).

Comment: Several commenters felt contract audits should be excluded from some of the audit followup requirements.

Response: Our review of agency's followup systems indicated no need for such an exemption, except as noted above.

Comment: One commenter suggested that we qualify the wording in subparagraph (5) to provide that when a "designee" is assigned to resolve a disagreement arising between the audit organization and a program office that the designee be independent of the program office.

Response: We believe this is understood.

John J. Lordan,
Chief, Financial Management Branch,

[FR Doc. 79-3703 Filed 11-20-79; 4:43 am]

BILLING CODE 3110-01-M

APPENDIX 1(D)(2)(b)

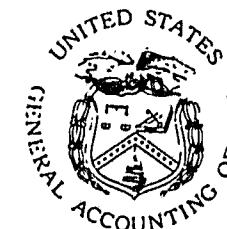
BY THE U.S. GENERAL ACCOUNTING OFFICE
Chairman, Subcommittee On Legislation
And National Security, House Committee
On Government Operations

Disappointing Progress In Improving
Systems For Resolving Billions
In Audit Findings

Although Government agencies spend hundreds of millions annually to audit Federal programs and operations, most of them still lack effective systems for resolving audit findings. In 1978, GAO reported \$4.3 billion in unresolved findings at 34 agencies. This report shows the problem is worsening.

Following GAO's 1978 report, the Office of Management and Budget revised its policy guidelines emphasizing prompt and proper resolution of audit findings. Most agencies' systems, however, are not yet in compliance. GAO turned up numerous examples of agency failures to correct problems or improve operations as recommended by audit.

OMB needs to clarify its policy guidance on audit resolution and extend its oversight to make sure agencies comply with it. Agency management must be made accountable for taking appropriate actions to resolve audit findings.



AFMD-81-27
JANUARY 23, 1981



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-200473

The Honorable Jack Brooks
Chairman, Legislation and
National Security Subcommittee
Committee on Government
Operations
House of Representatives

Dear Mr. Chairman:

This report is our response to your June 10, 1980 request for us to determine if agencies have in place audit resolution systems that meet Office of Management and Budget revised guidelines and General Accounting Office and House Committee recommendations. It follows up on our October 1978 report on the same subject.

This report shows that while some progress has been made, the absence of effective audit resolution processes is widespread and still a serious problem. It points out that the dollar value of unresolved audit findings has grown, but still remains a conservative figure because many agencies do not track audit findings to final disposition.

As you requested, we did not obtain agencies' official comments on this report; however, the facts were discussed with personnel of affected agencies and their comments were incorporated as appropriate. As arranged with your office, we plan no further distribution of this report until 30 days from its date unless you publicly announce its contents earlier. At that time, we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,

Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT
TO THE CHAIRMAN, SUBCOMMITTEE
ON LEGISLATION AND NATIONAL
SECURITY, COMMITTEE ON
GOVERNMENT OPERATIONS

DISAPPOINTING PROGRESS IN
IMPROVING SYSTEMS FOR
RESOLVING BILLIONS IN
AUDIT FINDINGS

D I G E S T

The Government is losing billions of dollars because agencies are not acting on audit recommendations to recover funds, avoid cost, and improve operations. Although Federal agencies' systems for resolving audit findings have improved somewhat in the past 2 years, progress overall has been disappointing.

MAGNITUDE OF THE AUDIT
RESOLUTION PROBLEM

In 1978, GAO identified \$4.3 billion in unresolved findings at 34 agencies involving potential recoveries, penalties, revenues, or savings. GAO now reports \$14.3 billion in unresolved monetary findings at these agencies. This represents a \$2.4 billion increase in nonregulatory audit findings and a \$7.6 billion increase in audit findings of possible overcharges by oil refiners and fuel suppliers to their customers. These unresolved energy regulatory audits represent potential rebates to customers from oil refiners and other fuel suppliers that violated energy regulations. They do not represent potential Federal budgetary savings. (See p. 7.)

GAO also now reports an additional \$10.5 billion in unresolved contract proposal audits and \$170 million in unresolved findings at agencies not in the 1978 report.

GAO considers the numbers to be conservative and believes they would be even higher if agencies kept better records of audit findings. (See pp. 6-7.)

AFMD-81-27

Tear Sheet. Upon removal, the report cover date should be noted hereon.

Agency audit reports also contained thousands of unadopted procedural recommendations that would improve Government operations and have a substantial dollar impact as well.

It cannot be assumed that all dollars associated with unresolved audit findings are potentially returnable to the Treasury. Findings are sometimes settled without a return of funds, or are not concurred with by program officials for valid reasons. Other findings result in a cost avoidance. The unresolved \$10.5 billion in contract proposal audit findings, which identify avoidable cost, falls into this category.

IMPROVEMENTS NEEDED IN AUDIT
RESOLUTION SYSTEMS

In response to GAO's 1978 report the Office of Management and Budget (OMB) revised Circular A-73, its policy guidelines on audit resolution. With some exceptions, these guidelines provide a solid framework for effective audit resolution. Also, most of the 71 agencies GAO studied have taken some action since 1978 to improve their audit resolution systems.

Still, much more needs to be done to ensure prompt and proper audit resolution. Agency systems must include provisions for:

- maintaining accurate records of findings until final disposition;
- establishing adequate accounting and collection controls over amounts determined to be due as a result of audit;
- elevating disagreements and delays to an independent arbiter;
- providing complete and accurate reports to management;
- applying Circular A-73 to all audits;

--deciding the disposition of audit findings in 6 months and establishing final resolution schedules;

--ensuring that decisions to reject findings are consistent with laws and regulations; and

--coordinating corrective action with other affected agencies.

GAO's detailed review at 10 agencies demonstrates how a failure to address these provisions results in delayed or improper audit resolution. For 193 of 249 audit findings GAO examined, officials failed to act promptly or properly to correct problems or improve operations.

The following examples illustrate what can happen when agency officials fail to follow up properly on audit findings:

- Over a 3-year period a subsidy recipient received excess payments of almost \$100,000, but did not refund the amount as required. Agency auditors considered the finding resolved in April 1980 based on evidence that the accounting division was advised of the debt 3 months earlier. When GAO checked in October 1980, the debt was still not under accounting control and no effort had been made to recover it. More than a year has passed since the accounting division was informed of the debt, during which time an additional \$258,000 was paid to the subsidy recipient.
- Agency officials asked a grantee to respond to an audit report that questioned \$298,000. The grantee never replied. More than a year later the agency warned the grantee that funding would be suspended if it did not reply. The grantee still did not respond, yet it was awarded another \$90,000. Since the audit report was issued the grantee has received over a half-million dollars. Meanwhile, problems with the

grantee continue; the next year's audit questioned the allowability of another \$71,000 and reported excess funds on hand of \$684,000.

- Auditors reported a subsidy program's goal of reducing grain production was being subverted because farmers were taking dry, barren land out of production rather than irrigated, fertile land. In one State, over a 1-year period, farmers received windfall payments of \$8.4 million. Agency administrators disagreed with the finding and indicated a willingness to live with the inequity. Windfall payments could occur again in 1981.
- In January 1979 auditors reported that two Federal agencies had both paid a day care operator \$478,000 for the same food service costs. Officials of the agency receiving the report took no action, claiming the dual funding was not their responsibility. Their counterparts at the other agency claimed that they were not told about the dual funding. The funds have not been recovered and the day care operator is still funded by both programs.

FACTORS IMPEDING PROMPT AND EFFECTIVE AUDIT RESOLUTION

Prompt and effective resolution of audit findings is dependent upon:

- OMB providing sufficient leadership to agencies for improving audit resolution systems (See pp. 24-25.),
- Federal executives and managers being accountable for audit resolution (See pp. 25-27.), and
- auditors consistently and appropriately developing and reporting audit findings and questioning the adequacy of administrator's resolution proposals and actions (See p. 27.).

RECOMMENDATIONS TO THE DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

The Director, OMB should:

- Include oversight of agency audit resolution practices in the budget review process to provide (1) an assessment of progress in establishing, revising, and implementing resolution systems, (2) an adjustment of agency budget allowances where appropriate, and (3) a report to the Chairpersons of the House and Senate Committees on Appropriations on progress and action plans.
- Clarify Circular A-73 so that (1) it provides that periodic reports to agency heads include complete details on the resolution of findings and on the age and amounts of unresolved findings, (2) it applies to all audit reports, including contract, subgrantee, and regulatory audits, and (3) written determinations and the legal basis for nonconcurrence with audit recommendations apply to both procedural and monetary findings.

RECOMMENDATIONS TO HEADS OF FEDERAL AGENCIES

Federal agencies should:

- Further improve audit resolution policies, procedures, and practices to comply with the intent and spirit of OMB guidelines, designating a top level manager to coordinate these efforts and prepare progress reports for OMB.
- Take legal or administrative actions against the parties involved whenever audit findings concern fraud, waste, or abuse of Federal funds.
- Make the timeliness and quality of audit resolution a written performance standard and a factor in determining bonuses for Senior Executive Service members and merit pay for supervisors.

RECOMMENDATION TO INSPECTORS GENERAL
AND DIRECTORS OF AUDIT ORGANIZATIONS

The inspectors general and directors of audit organizations should develop internal procedures and controls for efficient and effective planning, coordinating, reviewing, and reporting of audit work and audit followup activities in accordance with GAO and other professional standards.

AGENCY COMMENTS

At the request of the Legislation and National Security Subcommittee, House Committee on Government Operations, GAO did not obtain agencies' official comments on this report. However, GAO discussed the facts with personnel of affected agencies and incorporated their comments as appropriate.

Department or agency	Audit findings recent yearly period		Unresolved findings		
	Number of reports	Monetary findings (thousands)	Number of reports	Total	Over 1 year (thousands)
Consumer Product Safety Commission	6	\$ 102	1	\$ -	\$ -
Equal Employment Opportunity Commission	37	272	7	265	203
Federal Emergency Management Agency	102	4,119	22	3,790	-
Federal Mediation and Conciliation Service	6	b/	b/	b/	b/
Federal Trade Commission	16	29	5	2	-
Interstate Commerce Commission (internal only)	1	b/	-	-	-
Legal Services Corporation	356	616	137	1,968	1,371
National Credit Union Administration	3	-	3	-	-
National Endowment for the Arts	80	75	59	306	217
National Endowment for the Humanities	60	4,689	48	3,042	39
National Labor Relations Board	7	22	4	-	-
National Transportation Safety Board	4	b/	4	b/	b/
Railroad Retirement Board	11	b/	b/	b/	b/
Tennessee Valley Authority	68	2,700	3	90	-

APPENDIX II

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APPENDIX II

Department or agency	System excludes some findings or reports	Some evidence of premature closure	Inadequate accounting or collection controls	No written decisions within 6 months	No assurance that resolution is consistent with laws and regulations	Auditor/program official disagreements not elevated after 6 months	Semiannual reports to agency heads		No or inadequate procedures for coordinating corrective action
							Not prepared	Do not show how findings resolved	
Legal Services Corporation	X	X	X	X	(X	X		6/
National Credit Union Administration			6/)		X		
National Endowment for the Arts			X)	X		2/ X	6/
National Endowment for the Humanities			6/	2/ X	X	X		X	2. X
National Labor Relations Board			6/	X	X			X	X
National Transportation Safety Board	2/ n X	X	6/	X	X	X	X		
Railroad Retirement Board			X			X	X		
Tennessee Valley Authority		X	X	X	X	X	X		X
U.S. Postal Service	2/ r X	X	X	2/ c X	X	X	X		

APPENDIX 2

LSC MATERIALS IN RESPONSE TO QUESTIONS
RAISED AT FEBRUARY 26, 1981 HEARINGS

- A. Dan J. Bradley, President of LSC, letter to Honorable Barney Frank (Representative from Massachusetts) concerning legislative representation activities, dated March 9, 1981.
- B. Dan Bradley, letter to Honorable M. Caldwell Butler (Representative from Virginia) concerning lawsuit against the Community Services Administration, dated March 9, 1981, including LSC reply to Wall Street Journal article.
- C. Dan Bradley, letter to Honorable M. Caldwell Butler concerning GAO Report on Audit Issues, dated March 9, 1981, including exhibits on audit issues.
- D. Dan J. Bradley, letter to Honorable M. Caldwell Butler concerning salary capabilities of legal services attorneys, dated March 9, 1981.
- E. Dan J. Bradley, letter to Honorable Robert W. Kastenmeier (Representative from Wisconsin), Chairman, Subcommittee on Courts, Civil Liberties and the Administration of Justice, concerning "reasonable" access to justice and inflation, dated March 9, 1981.
- F. Dan J. Bradley, letter to Honorable Harold S. Sawyer (Representative from Michigan) concerning legal needs of moderate income persons, dated March 9, 1981.
- G. Dan J. Bradley, letter to Honorable Harold S. Sawyer concerning the number of low-income persons unable to be served, dated March 9, 1981.

APPENDIX 2(A)



LEGAL SERVICES CORPORATION
733 Fifteenth Street, N.W., Washington, D.C. 20005

Writer's Direct Telephone
(202) 272-4040

Dan J. Bradley
President

March 9, 1981

The Honorable Barney Frank
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Frank:

I am writing in further response to questions you raised last week at our oversight hearings before the House Judiciary Subcommittee on Courts, Civil Liberties and the Administration of Justice. In a discussion about the legislative representation activities conducted by legal services attorneys, you asked for the number of complaints about these activities by members of state legislatures.

As you know, legislative representation activities by legal services attorneys are governed by the provisions of the Legal Services Corporation Act as amended and Corporation regulations. These are extremely sensitive activities, and the Corporation has made every effort to ensure that at all times they are conducted in a professional manner, in full compliance with the law. On occasion, a member of Congress has directed complaints about these activities to the Corporation for investigation and review. Staff from our regional offices and our General Counsel's office carefully review the complaints for compliance with the law. I can report very few instances of violations of the Act or regulations concerning these most sensitive provisions of law.

During the 1980 calendar year, the Corporation received 20 inquiries from Members of Congress concerning the legislative representation activities of employees of our grantees. None of the 20 inquiries concerned complaints from members of state legislatures alleging improper conduct on the part of legal services employees. Nine of the 20 inquiries concerned complaints about legal services representational activities at the state level, although none of the nine stemmed from members of the legislative body itself. Two of the inquiries concerned allegations from local officials regarding improper conduct on the part of legal services employees. The remainder were general in nature concerning the authority of legal services attorneys to engage in legislative representational activities.

BOARD OF DIRECTORS — Hillary Rodham, Chairman, Little Rock, Arkansas

Steven L. Engelberg
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LEGAL SERVICES CORPORATION

The Honorable Barney Frank
Page Two
March 9, 1981

I hope this information is of assistance to you. I would be glad to discuss this or other issues of concern to you at your convenience.

We are very appreciative of your strong support.

Sincerely,

Dan
Dan J. Bradley

cc: The Honorable Robert W. Kastenmeier
The Honorable Thomas F. Railsback

APPENDIX 2(B)



LEGAL SERVICES CORPORATION
733 Fifteenth Street, N.W., Washington, D.C. 20005

Writer's Direct Telephone
(202) 272-4040

Dan J. Bradley
President

March 9, 1981

The Honorable M. Caldwell Butler
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Butler:

I am writing in further response to the questions you raised at the oversight hearing on the Legal Services Corporation (LSC) held by the House Judiciary Subcommittee on Courts, Civil Liberties and the Administration of Justice. You will recall asking questions on three different LSC-related issues to which I promised to provide you with additional information.

The first of these issues concerned the lawsuit, referred to in the Wall Street Journal as a "sweetheart" lawsuit, involving legal services attorneys. On August 20, 1980, the Wall Street Journal published an article written by Heather Stuart Richardson entitled, "A Sweetheart of a Lawsuit?" The article alleged collusion between the plaintiffs' and defendants' attorneys in the settlement of a lawsuit, to the detriment of their clients.

The defendant in this suit, the Community Services Administration (CSA), prepared a detailed response to the article which thoroughly addressed the various allegations made by the reporter. I have attached a copy of the CSA response for your information. A review of the facts can only lead to the same conclusion reached by CSA -- the article was both biased and factually inaccurate in its presentation of the information.

At the outset, it is important to mention some rather important omissions in the article. First, the article failed to note the plaintiff's primary contention in the lawsuit, the fact that CSA, in direct contravention of Congressional intent, limited its energy assistance to only those persons who were delinquent in their payment of utility bills. Those low-income persons who sacrificed other necessities in order to prevent a shut-off of utilities were illegally denied bill-paying assistance under CSA's program.

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LEGAL SERVICES CORPORATION

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After unsuccessful attempts to change CSA's eligibility requirement of a shut-off notice, lawyers representing a class of poor and elderly persons brought suit against CSA requesting that the program be reopened and the unspent funds be distributed to those low-income persons who previously should have received help.

The attorneys representing the plaintiffs did not all work for LSC-funded programs. Two of the attorneys work for Senior Citizens Legal Services in Illinois -- a program funded with Title III Older Americans Act money and one attorney works for Legal Services for the Elderly in Augusta, Maine -- a program which does not receive LSC funds. The other two attorneys who signed the settlement agreement do work for LSC-funded programs in Pennsylvania.

Any claim of collusion between these attorneys and CSA, or CSA grantees who would benefit from the settlement, is without basis in fact. The lawsuit was developed independently to further the best interests of the class of low-income clients being represented. There was no contact between plaintiffs' attorneys and those groups who were to receive grants from CSA as a result of the settlement. Of course, none of the plaintiffs' attorneys or the programs for which they worked were to benefit from the settlement in any way. Also, the relationship with CSA itself was strictly adversarial. Settlement discussions were initiated, in large part, because Judge Grady, the U.S. District Court judge hearing the case, indicated that he was inclined to rule in favor of the plaintiffs.

CSA claimed that it would be extremely difficult, if not impossible, to reopen the prior year's energy program and identify those persons who should have received assistance while they were in the midst of the present year's much larger and somewhat different fuel payment assistance program. As an alternative, CSA offered to use the past year's energy assistance funds on programs which would assist a whole class of poor and elderly persons with energy problems.



LEGAL SERVICES CORPORATION

The Honorable M. Caldwell Butler
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With the exception of named plaintiffs, individual members of the class of plaintiffs did not receive cash awards. However, to conclude as the Richardson article did, that the funds were not to be "used to alleviate the burden of rising fuel prices on the poor", is inaccurate.

The settlement provided that some 10,000 households in at least 15 northern states would be provided with kits of clothing that were to include thermal underwear, a quilted vest, jacket, boots, a knit cap, and blanket. Some 60,000 households were to be served with energy conservation kits that would have included caulking material, tape for doors and windows and other weatherization items.

Further, under the initial settlement, households of poor and elderly people were to receive at least 2,400 solar applications including hot water heaters, air heaters, solar attached greenhouses, and south wall glazing.

Also to be funded were advocacy programs to represent elderly and low-income energy consumers in their efforts to halt the rapid rise in fuel costs. This was the aspect of the settlement which caught the attention of the media and which angered the utility representatives. One of the reasons for the incorrect impressions in the Journal article was that the only person quoted was Peter Metzger, who apparently works for a utility company in Colorado.

The Capital Legal Foundation attempted to intervene in the litigation and sent letters to CSA and Judge Grady. As a result of the extremely negative publicity and this attempted intervention, the judge decided to rehear the case. Judge Grady set aside his original decree on October 29, 1980, on the ground that the class of plaintiffs had not been certified prior to the settlement. The judge also questioned the extent of his and CSA's authority, specifically whether CSA had the authority, on its own, to carry out the activities of the settlement.



LEGAL SERVICES CORPORATION

The Honorable M. Caldwell Butler
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The matter is now on appeal. Briefs were submitted in January and oral argument was held on February 12, 1981. The parties' briefs address both the ethical issue and defend the attorneys' actions in the case. The court will finally decide the issues involved. If you would like a copy of the briefs, please let me know.

I hope this response answers any questions you or other members of the Subcommittee may have had after reading the Wall Street Journal article. If I can be of any further assistance, please do not hesitate to contact me.

Sincerely,

Dan

Dan J. Bradley

Attachment

cc: The Honorable Robert W. Kastenmeier
The Honorable Thomas F. Railsback

REPLY TO THE WALL STREET JOURNAL ARTICLE REGARDING

SIMER V. OLIVAREZ LAWSUIT

I. INTRODUCTION

On August 20, 1980, The Wall Street Journal published an article entitled, "A Sweetheart of a Lawsuit?" which was reprinted in The Washington Post on August 31, 1980.

The article criticizes a court ordered settlement entered into between the Community Services Administration (CSA) and the attorneys for poor and elderly plaintiffs complaining they had been illegally excluded from CSA's 1978-1979 winter emergency energy crisis program. The article charges that the lawsuit was a "sweetheart" arrangement under which the lawyers who filed the suit and the Federal agency sued colluded so as "to render Congress's intentions moot and feather their own nests: Leave money unspent, be sued and settle as thou and they can best profit."

As will be shown below, the charge is baseless and the article irresponsible. However, the seriousness of the charge and the interest inevitably generated by its being featured in both the Journal and the Post require that the actual facts be set forth in detail. What follows below may

not be as colorful or interesting as the Journal article, but it does have the advantage of accuracy. It shows that the federal agencies involved acted with integrity and that the terms of the settlement were well within the authority delegated by Congress. The Federal Government argued its position and lost. At that point it settled the case in a manner which would benefit the class of elderly and poor citizens on whose behalf the lawsuit was filed.

II. CSA'S 1978-1979 ENERGY PROGRAM

For Fiscal Year 1979, Congress appropriated monies to CSA to carry out programs which would assist the poor and elderly in coping with the energy crisis, particularly during the winter months. Two hundred million was appropriated for grants to community action agencies to provide direct assistance such as bill payments, warm clothing, and small heating appliances. Nearly \$10,000,000 was appropriated for other programs of energy technical assistance and conservation efforts. For example, grants were made to low-income groups to enable them to participate effectively in rate making proceedings, to assist them in participating in local planning and decision making in the energy area, and to build and use low-cost energy saving devices such as solar hot water heaters.

In its regulations published to implement the program, CSA limited eligibility for bill-payment assistance to only those applicants who had received a notice that their heat or light was to be shut-off for failure to pay their bills. The regulation was adopted as a limiting device under which only those in serious crisis would receive the limited assistance available. However, otherwise eligible applicants who were not in imminent danger of a utility shut-off, but were encountering some other form of energy crisis were eligible to receive a variety of assistance, ranging from blankets to payment of food bills for those who had no money for food after paying energy bills.

CSA awarded grants for this program to some 900 community action agencies nationwide, many of whom in turn delegated the funds to various neighborhood organizations. Of the \$200,000,000 appropriated, almost all was committed by the grantees to applicants by June 30, 1979, the cut-off date set forth in CSA's regulations for local organizations providing assistance to applicants. Monies unspent as of June 30, 1979, by the organizations awarded grants were under law to be returned to CSA. It was these monies that were the subject of the lawsuit.

III. THE LAWSUIT

Six low-income people from different parts of the country, assisted by Federally-funded legal assistance attorneys, filed suit on September 24, 1979, nearly three months after the 1978/1979 winter program was over, alleging

that they and an undisclosed number of other poor people had been illegally denied bill-paying assistance under CSA's program. These plaintiffs asserted that the CSA requirement which limited bill-payment assistance to applicants with shut-off notices was illegal because Congress had stated in CSA's legislation that "(e)ligibility for any of the programs authorized under this Section shall not be based solely on delinquency in payment of fuel bills."

CSA together with the Department of Justice represented by the office of the United States Attorney for the Northern District of Illinois, in Chicago, filed a response that the regulation was valid since applicants without shut-off notices were still eligible for crisis assistance in forms other than bill payment. Both parties filed briefs on their position and oral argument was held on January 4, 1980. After hearing from both sides, the Court sided with the plaintiffs^{*/} and a settlement as to the monies was developed to recompense the class of poor and elderly who had been excluded in violation of Congressional intent.

^{*/} "THE COURT: I think that the plaintiffs are entitled to judgment to the effect that anybody who was denied fuel assistance for failure or inability to produce a cutoff notice, was deprived of benefits to which he might otherwise have been entitled under the statute. That much is clear to me." (Transcript, Jan. 4 proceedings.)

Thus, rather than engaging in collusion or "sweetheart" arrangements, CSA, together with the United States Attorney denied plaintiffs' allegation and energetically defended its regulation. No appeal was taken of the trial court's position because the court and plaintiffs were essentially correct. In its haste to publish regulations and get monies out to meet the winter crisis, CSA adopted eligibility requirements which were more restrictive than Congress intended or allowed. It would have been both frivolous and futile to appeal the decision any further, and no attorney at the Department of Justice in Washington, D.C., CSA, OMB, or in the United States Attorney's office in Chicago suggested otherwise. CSA was faced with the reality that the Court would not allow the unspent funds to be returned to Treasury and was going to order that the funds be made available to recompense the poor and elderly who had been improperly excluded from the previous winter's program. Rather than leave the terms of that recompense to the plaintiffs and the judge, the attorneys from CSA and the United States Attorney's office entered into negotiations in order to insure that the terms under which CSA would be required to expend the remaining monies were reasonable and within CSA's authority and ability to accomplish.

IV. THE SETTLEMENT

The settlement and the process by which it was reached were both legal and proper. It was reached with the knowledge and approval of the District Court, the United States Attorney for the Northern District of Illinois, the Office of Management and Budget, the Department of Justice, and the Community Services Administration. While the attorneys for plaintiffs were free to push for any form of expenditure benefiting the class they were representing, CSA attorneys looked to what Congress had authorized in appropriating Fiscal 1979 monies to CSA. The terms of the settlement agreed to by CSA and ordered by the Court go no further than Congress had authorized by law in creating CSA and in appropriating fiscal year 1979 monies to CSA. The specific intent of assisting poor and elderly to get through the winter of 1978/1979 obviously could not be met in a settlement directed by the Court in January, 1980. However, the broad authority given CSA by Congress did permit a settlement which will substantially benefit the plaintiff class without going beyond the authority of CSA over its 1979 appropriations.

Section 222(a)(5) of the Economic Opportunity Act authorizes not only bill-payment assistance but a broad range of energy assistance activities for poor people. CSA had already funded numerous grantees to provide a range

of assistance beyond the payment of utility bills. The 1979 appropriation was legally available not only for bill payment programs but also for the other energy activities authorized under Section 222(a)(5) of the Economic Opportunity Act. However, by committee report, it was clear that, while Congress left CSA with legal authority to fund any activity authorized under Section 222(a)(5), Congress expected \$200,000,000 to be expended on direct assistance for bills and other winter crises and only some \$10,000,000 for the broad range of more indirect energy assistance authorized under Section 222(a)(5).

The issue, then, is not whether CSA went beyond its legal authority in agreeing to the terms of the settlement, but whether in exercising its broad authority over 1979 appropriations, it used sound judgment and to the degree feasible, kept faith with Congressional expectations for 1979 funds. Given the limited options available to CSA as the losing party in the legal action, CSA feels that anyone taking the time to look into the issue will agree that the option taken by CSA was the only responsible course of action. In order to understand this clearly, an understanding of the alternatives available to CSA is necessary.

1. Add the \$18,000,000 unspent from 1978-1979 winter program to the billion dollar CSA administered program for the 1979-1980 winter.

This was not an option available to CSA, because of who the plaintiffs were. The settlement had to benefit the poor and elderly who had been excluded from the prior year's program. This option would have been of zero benefit, the plaintiffs' attorneys would not have agreed to it, and it was highly unlikely the Court would have ordered it over plaintiffs' objections. Most plaintiffs were already eligible for the 1980 program of \$1.6 billion.

Plaintiffs were aware that there would be monies left over from this program and that adding the \$18,000,000 would simply add to the amount to be returned to Treasury after the cut-off date of the 1980 program, thereby providing no benefit to plaintiffs' class at all.

2. Run a separate \$18,000,000 bill-payment program during the 1980 winter, limited to the poor and elderly class excluded from the 1979 program.

At first glance, this option would appear to make the most sense and would clearly have come closest to Congressional

intent as expressed in committee reports. However, it would have been an unwise and irresponsible choice. When Congress expresses its intent through committee reports rather than by way of a statutory earmark, it intends that the agency retain flexibility to meet changed circumstances. As the General Accounting Office, an arm of Congress, has stated:

In this regard, Congress has recognized that in most instances it is desirable to maintain executive flexibility to shift around funds within a particular lump-sum appropriation account so that agencies can make necessary adjustments for 'unforeseen developments, changing requirements, incorrect price estimates, wage-rate adjustments, changes in the international situation, and legislation enacted subsequent to appropriations.'***

Accordingly, it is our view that when Congress merely appropriates lump-sum amounts without statutorily restricting what can be done with those funds, a clear inference arises that it does not intend to impose legally binding restrictions, and indicia in committee reports and other legislative history as to how the funds should or are expected to be spent do not establish any legal requirements on Federal Agencies.***
(55 Comp. Gen. 318, 319, 1975)

Clearly then, Congress intends that CSA use the flexibility afforded by Congress to best meet changed circumstances. Here, circumstances had changed drastically for CSA. CSA was in the midst of administering close to a billion dollars under its 1980 Emergency Crisis Assistance Program (ECAP).

It was also in the process of resolving issues and audits from the previous year's \$200,000,000 energy program and a previous court ordered energy program of \$48,000,000. To have also started an additional \$18,000,000 program, with necessarily separate regulations and eligibility criteria, would have been beyond CSA's capacity to properly monitor, audit, and administer. To have pretended that we possessed such a capacity in order to stave off Congressional or public inquiry would have been irresponsible. Further, CSA was aware of Congressional criticism of the management capabilities of CSA's grantees across the country as to their administration of the 1978, \$200,000,000 payment program.

Given the fact that the same grantee network was in the midst of trying to administer a billion dollar 1980 effort, the imposition of an additional, separately administered \$18,000,000 program was inadvisable.

A third difficulty with this option is that it assumes the individual members of the class are identifiable. The problem with payments to a class, as with any form of direct individual assistance, is that identifying the actual members of the illegally excluded class comes close to being impossible. Here the class included not only those who applied and were rejected in 1979 but those who would have applied but didn't because they knew that a shut-off notice was required. The court recognized this difficulty. Judge Grady stated during the January 4, 1980, hearing:

How are we going to find out which persons were chilled from applying because of knowledge of this shutoff notice requirement? How are we going to gather the facts on which persons, other than your named plaintiffs, were turned down on that account in the region? We could spend the 15 million dollars gathering the facts in this case. I say that facetiously, but by the time we gather them, it will be another year down the road and then we would be in the '81 program before we decided who was actually entitled to any money. Is it worth it?

Even if these administrative difficulties were to be overcome, the minimal value of this option to poor people made it inadvisable. At the time of the settlement, the poor and elderly were eligible for the billion dollar ECAP winter program, which had more generous terms of assistance and broader eligibility requirements. To have spread an additional \$18,000,000 program among 50 states, 900 grantees and thousands of subgrantee neighborhood outlets would have resulted in subgrants so small as to be of negligible value to the plaintiff class and less than negligible value to the grantees, who would have had to accept the additional regulatory requirements. Acting on the flexibility afforded by Congress, CSA rejected the alternative of running an \$18,000,000 bill-payment program and sought an alternative which would be within both its authority and its capability.

3. Fund a number of successful CSA energy projects to provide direct assistance and also indirect assistance intended to result in permanent benefits to the class.

This was the option chosen by CSA as a negotiating position and the settlement terms are in accord with this alternative. The grants provided for under the terms of settlement are detailed in Attachment A. In summary, \$4,000,000 will be awarded for a hypothermia program providing 10,000 elderly households in 15 northern states with an energy audit, special winter clothing, and nutrition education. Four million dollars will be awarded for basic insulating materials such as caulking, weather stripping, and window coverings to serve 60,000 households, \$2,000,000 for a solar installation program including materials for hot water and air heaters in 2,600 households, \$6,500,000 for various energy advocacy projects throughout the country, \$1,000,000 to involve poor and elderly in their community's energy planning and assessment of needs, and \$150,000 to reduce energy costs on small farms. If circumstances change, the settlement allows for court approved modifications in the funding levels set forth above.

As shown above, these activities are authorized under CSA's enabling legislation and the 1979 appropriation passed by Congress. While the author of the Journal article regards the grants agreed to by plaintiffs and CSA as "pet projects which otherwise might have been terminated because of opposition or a lack of interest in Congress," there is no illegality or impropriety in funding valuable projects

authorized under a 1979 appropriation even though Congress does not intend to appropriate sufficient funds to continue all such projects in succeeding fiscal years. CSA must look to the 1979 appropriation in determining an authorized and appropriate use for held-over 1979 funds, not to current Congressional intent. Also, plaintiffs were not likely to agree to any use of the 1979 appropriation which would merely add to projects for which there were ample current appropriations, again on the theory that plaintiffs were seeking some form of recompense they would not otherwise obtain.

V. CONCLUSION

It should be apparent from the above that if balanced journalism remains a goal of The Wall Street Journal and The Washington Post they have fallen short of the mark in this instance. Attachment B details the article's inaccuracy.

While the wisdom of certain discretionary grant judgments made by an executive agency is always open to question, and while CSA can properly be asked to defend those judgments, there is little value in CSA spending time defending baseless charges of collusion and illegality. The Simer settlement was legal, the process was handled with integrity, and CSA stands behind the appropriateness and the wisdom of the results.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS

ELSIE SIMER, HILDA SPINEY, ARLENE
WHITEHOUSE, ARTHUR BOUCHER, ROSE
and ROBERT HENERSON, HILDA BELLER,
DEBRA JONES, et al.

Plaintiffs,

-v-

WILLIAM ALLISON, Acting Director of
Community Services Administration;
COMMUNITY SERVICES ADMINISTRATION,

Defendants.

No. 79C3960

STIPULATION AND AGREED ORDER

Now come the plaintiffs, ELSIE SIMER, et al., by their attorneys, and the defendants, the Acting Director of Community Services Administration (CSA) and CSA, by their attorneys, and do hereby stipulate and agree to the following terms for the purpose of a fair settlement of Simer et al. v. Olivarez, et al.,

1. The parties have consulted with one another in an effort to settle this matter in an expeditious and fair manner in order that funds be made available to enable CSA's grantees to respond to winter-related energy crises which endanger the health and survival of low-income households and/or result in substantially increased energy costs.

2. None of the parties admit any liability or wrongdoing under the terms of the settlement of the pending lawsuit nor concede the validity of the positions asserted by the others.

ATTACHMENT A

3. All unexpended monies from the 1979 Crisis Intervention Program (CIP), estimated to date to be approximately eighteen million dollars remaining from an original \$200 million for CIP appropriated by Congress for FY '79, shall be used to effectuate the following programs and provisions in the manner described herein.

4. CSA agrees to provide a total voucher credit of \$250 to the current gas, oil, or electric utility of the individual named plaintiffs or a direct payment of \$250 to the named plaintiffs.

5. Eligibility of any applicant for programs detailed in paragraphs six through eleven shall be based on 125% or less of the CSA income poverty guidelines in effect at the time of application. No proof of a shut off notice or any evidence of unpaid utility bills is necessary for program eligibility. Priority shall be given to the elderly and those unserved by CIP.

6. CSA agrees to fund a four-million dollar hypothermia program in at least fifteen northern states to serve approximately 10,000 households. Hypothermia is a condition which results from failure of the body's thermo-regulatory system to respond properly to cold. Specifically, projects will focus on the following activities:

- a. an energy assessment of the target home;
- b. an explanation of energy saving techniques designed especially for this client group;
- c. nutrition education related to the maintenance of body heat; and,
- d. provision of a personal "kit" of appropriate clothing in a special package consisting of such items as thermal underwear,

7. CSA agrees to provide four million dollars for the support of a program to supply emergency energy conservation kits to eligible elderly and low-income households. Program grants shall be approximately \$50,000, of which at least 80% shall be for the cost of the kits themselves. A maximum of 15% shall be available for program administration and support costs, including training, outreach, transportation costs, and publicity. A maximum of 5% shall be available for administration costs including audit and insurance. Wherever possible, other resources shall be mobilized for such program support costs, including the use of community or ACTION volunteers, and preference will be given to grantees who, through such resource mobilization, are able to reduce program support costs below 15%. CSA agrees that approximately 60,000 households will be served with conservation kits, which will average approximately \$50 in cost.

8. CSA agrees to fund a two million dollar solarization program in two components:

(a) an operational solar installation program consisting of \$1.2 million in grants for materials for solar devices. Grants will number between 80 and 150 and will be of no more than \$45,000, with the average at approximately \$10,000. They will result in the installation on the homes of poor and elderly persons of at least 2400 solar applications, including hot water heaters, air heaters, solar attached greenhouses, and south wall glazing. Costs of labor and overhead will be supplied from other sources, including, where available, CETA, and grantees will be encouraged to leverage additional funds for program expansion.

(b) \$800,000 for the support of at least four regional solar

resource centers which will provide workshop training, technical assistance, design services, and system monitoring and evaluation assistance to the operational grantees. Center workshop training activities will include materials costs for the installation of a minimum of 200 additional solar applications on homes of the poor and elderly.

9. CSA agrees, to disburse 6.5 million dollars for low income and elderly consumer advocacy in energy issues by funding the following programs for a two year period commencing in 1980 as follows:

a) 4 million dollars shall be granted to local groups to fund advocacy efforts on behalf of elderly and/or low income persons with regard to energy issues affecting them, subject to the following requirements:

(1) grants for groups shall average \$75,000 per year and at least four groups so funded will be advocacy groups which are not being funded by CSA as energy advocates as of the date of this Order.

(2) in selecting which applicants are to receive funds CSA shall give preference to those applicants which can show a demonstrated capability in the following areas, and which propose in their work programs the conduct of activities in these areas:

(a) energy availability and access to energy sources, including customer service issues; (b) energy costs and local, state, or federal energy regulatory policies; (c) impact of energy problems on basic necessities such as housing, food, transportation, including building performance standards; and (d) impact of energy conservation, weatherization, and alternative energy

development policies on elderly and/or low income persons.

(3) Grantees must utilize at least fifty (50) percent of any grant under this program to contract with existing legal programs serving low income people as authorized under 42 U.S.C.A. 3001 or 42 U.S.C.A. 2701 or Title XX of the Social Security Act. This 50% legal component may be waived only for those grantees who currently have on staff full time attorneys working exclusively on energy advocacy or for those grantees that can show in writing a commitment from a practicing legal service program serving consumers for the availability and use of a full time attorney/paralegal for two years for energy advocacy.

(4) Funding and administration/ monitoring of these grants shall be the responsibility of CSA Headquarters.

(a) \$1.8 million shall go for a grant to National Consumer Law Center on August 1, 1980 to be used solely for a two-year budget to maintain and expand its current advocacy, research, and active litigation with regard to state, federal and local utility and energy issues.

(b) In addition to the \$1.8 million in Section 9b, Defendants shall grant the National Consumer Law Center \$.5 million to be used over two years for expert witness and consultant fees in regard to energy and utility problems affecting low income utility consumers.

The \$.5 million shall be distributed to CAP energy advocacy grantees, legal services organizations or other consumer utility advocacy groups to be used for expert witness or consultant fees in

energy and utility matters in which those groups are representing low income consumers less 2% for travel costs for the advisory committee (limited to allowable costs under current U.S. government regulations). Requests for fund distribution shall be reviewed and recommended by a five-person advisory committee to be appointed by NCLC, subject to CSA approval, ^{and} based on the likelihood of successfully helping a large number of low income utility consumers and other criteria to be established by NCLC. An NCLC employee shall be a non-voting member of the advisory committee. All consultant contracts shall be approved by CSA as required by 45 CFR §1068.41. Advisory committee members shall be persons knowledgeable about energy problems of low income persons and about energy and utility issues. Neither advisory committee members nor the organization by which they are employed shall be eligible to receive, either as expert witness or as advocates employing such witnesses, funds distributed by the committee.

NCLC, if requested, may assist groups receiving part of the \$500,000 in the cases for which the funds are to be used but NCLC assistance shall not be a condition of receiving the funds, nor shall the committee consider the failure to request assistance from NCLC as a negative factor in making its determination. NCLC shall submit to CSA, which in turn shall report to the plaintiffs' attorneys, names and address of witnesses, amount spent, dates and hours of service, nature of case, and results. All funds not expended after two years from the date the grant will be refunded to CSA.

d) A grant of \$200,00 shall go to Citizen/Labor Energy Coalition

Foundation of Washington, D.C. to fund for a two year period staff, travel, and materials for providing training and technical assistance in organizing and coalition building for those advocacy groups funded under paragraphs 9a, and 10b.

10. CSA shall provide funds totaling one million dollars for

a) Emergency Preparedness/Impact Assessment programs and b) Community Energy Planning programs that will assure the participation of the poor and the elderly and the consideration of their needs in the community energy planning process.

a) Emergency Preparedness/Impact Assessment program funds will provide a single two-year grant of approximately \$400,000 for a comprehensive assessment of the impact on the poor and the elderly of developments in the energy market; and assessment of state, local, and national legislation, programs, and policies relating to and affecting energy usage, pricing, distribution, and development, including the areas of housing, transportation, and rural development. Included will be the assessment of special impacts such as landlord abandonment, FHA and HUD mortgage default, and the nutritional impacts on the many elderly who have been forced to reduce food budgets to pay for heat. Information generated will be made available to CSA and its grantees, including the energy advocacy grantees, to be used in on-going efforts to assure that energy related government programs and policies at all levels will be responsive to the needs of the poor and the elderly. In addition, successful local community efforts to reach by-passed populations in the implementation of recent energy assistance programs, and to plan for winter energy emergencies, will be documented and used as the basis for assistance to local communities in planning for winter emergencies. Assistance will include a number of regional training programs focusing on community preparedness, and updating of existing resource material based on these experiences.

b) CSA will award a minimum of fifteen eighteen-month grants of at least \$30,000 to Community Action Agencies to provide staff and administrative support for community energy planning. Grantees will build community coalitions of all sectors (public, private, organizations serving low-income people and the elderly) to join in organizing the community to identify and assess the sources and uses of energy in the community, identifying ways to create greater local energy self-sufficiency through use of renewable energy sources, and ensuring that programs adopted address the special economic, employment, or environmental needs of the poor and the elderly. CSA will also award a national technical assistance grant of approximately \$100,000 to assist planning grantees in areas such as identifying energy alternatives, determining employment potential of different renewable technologies, organizing coalitions, and legal and building code considerations in meeting community energy needs.

11. CSA agrees to fund the Small Farm Energy Project of the Nebraska Center for Rural Affairs located in Walthill, Nebraska to continue its development of low-cost application of small-scale, alternative energy for use on small farms at a level of \$150,000 for two years.

The project will continue to provide technical assistance and limited capital on a cost-sharing basis to develop on-farm innovations to conserve energy, recycle resources, and produce energy flow from sources on the farm. The emphasis will be on innovations that are home-built, easily maintained, fitted to the farmers' normal production patterns, and constructed from materials readily available throughout rural areas.

The project will assist in a dissemination effort to bring its findings to other low-income farmers. Participating farmers will be enlisted in instructing other low-income farmers in on-farm energy applications, in the immediate area, and throughout forty counties in the western cornbelt area of Nebraska, Iowa, Southern Minnesota, and South Dakota. Project results will be disseminated nationwide through a project newsletter, film and film strips, and a speakers' bureau.

12. \$350,000 is set aside for the following purposes:

Three professionals at the GS 12/13/14 level and one clerical at the GS 7/9 level shall be hired for a period of two years for headquarters' assistance in the administration and monitoring of the programs set forth herein. In addition, travel expenses of CSA employees in monitoring and administering these programs shall be met from these funds. CSA shall also publish manuals, handbooks, and pamphlets pertaining to these programs, and shall ensure that these publications be translated into Spanish and Chinese as appropriate and distributed accordingly.

13. All funds granted or contracted for by CSA pursuant to this Order are subject to pertinent provisions in the Economic Opportunity Act of 1964, as amended, and applicable CSA regulations and directives.

14. Plaintiffs shall waive all attorneys' fees and CSA shall reimburse plaintiffs for any costs permitted by law. Such a bill of costs shall be submitted within ten days of entry of the Order in this case.

15. Defendants shall supply to the plaintiffs detailed progress reports on actions taken to carry out the provisions of the paragraphs of this settlement. The first report shall be submitted by December 31, 1980 with subsequent reports every six months thereafter concluding with a final report due by December 31, 1982. Such reports shall include, but are not limited to a) a brief summary of each grant made with funds available under this stipulation including identity of grantees, amount and dates of grants, and a brief description of the local program; b) breakdown by each program area and number of household served (where applicable) and c) copies of any evaluation prepared by or for CSA.

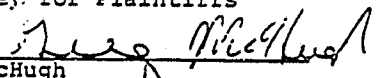
16. Instances where CSA obtains the return of funds obligated, it shall reobligate such funds to grantees fulfilling the specific purpose of the paragraph under which the grant was awarded.

17. Any additional monies returned to CSA in excess of eighteen million shall not revert to the United States Treasury but shall be subject to the jurisdiction of the Court and shall be obligated by CSA in accordance with a plan to be agreed upon by all parties and approved by the Court.

18. Agreed modifications of this Stipulation and Agreed Order not affecting substantial rights and obligations of all parties need not be presented to the Court for approval. Modifications

which substantially affect the rights and obligations of the parties, whether agreed to or not, and modifications to which the parties can not agree shall be presented to the Court by either party upon motion and notice to all parties twenty-one days prior to hearing.

Attorneys for Plaintiffs


 Greg McHugh
 Senior Citizens Legal Services
 Cook County Legal Assistance
 Foundation, Inc.
 1701 South First Avenue
 Maywood, Illinois 60153

Joan Glanton Howard
 Senior Citizens Legal Services
 Cook County Legal Assistance
 Foundation, Inc.
 1701 South First Avenue
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Nancy Brockway
 Legal Services for the Elderly
 P.O. Box 2723
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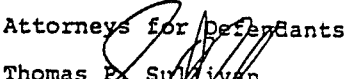
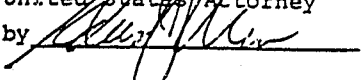
Jeffrey Greenwald
 Lehigh Valley Legal Services
 15 South 3rd, Room 404
 Easton, Pa. 18042

Paula Munson
 Central Pennsylvania Legal Services
 105 Prince Street
 Lancaster, Pa. 17603

SO ORDERED:


Dated: APR 25 1980

Attorneys for Defendants


 Thomas P. Sullivan
 United States Attorney
 by 

Edward Moran
 Assistant United States
 Attorney

Frank N. Jones
 Assistant Director for
 Legal Affairs and General
 Counsel
 Community Services
 Administration
 1200 19th Street, N.W.
 Washington, D.C. 20506

By: 
 Alan Dockterman
 Assistant General Counsel
 for Litigation

JOHN F. GRADY

John F. Grady
 United States District Judge

INACCURACIES IN THE WALL STREET JOURNAL

ARTICLE CONCERNING SIMER v. OLIVAREZ LAWSUIT

The article in the August 20, 1980 Wall Street Journal entitled "A Sweetheart of a Lawsuit?" offers readers a distorted and underdeveloped picture of the events surrounding the Order entered in Simer v. Olivarez, a lawsuit filed on behalf of low-income people challenging the administration of the 1979 energy crisis program by the Community Services Administration (CSA). In the order of appearance in the article, the inaccuracies and innuendos which particularly merit correction and clarification are the following:

• Item: The settlement resulted in funding for "quasi-public community action groups with a good deal of political clout."

Response: The accusation that CSA makes funding decisions on the basis of political clout is without foundation. Nowhere in the article is there any evidence to substantiate this claim: no instance of political pressure by any politician or any other individual, no identification of any funding decision with any political party, and no charge that any grantee would be funded because of its political influence.

• Item: ". . . in bypassing the normal route, CSA had 'eliminated Congress's decision-making authority.'"

Response: By its administration of the 1979 program, CSA bypassed no "normal route." Congress, not CSA, appropriates funds for the executive branch. Congress, not CSA, by a continuing resolution determined the level of fiscal year funds. The resolution provided a lump sum appropriation to CSA for continuing activities which were conducted in FY '78. CSA-funded activities in FY '78 included a fuel bill payment program and many of the projects which will receive continued funding under the Court Order. Thus, the author is erroneous in blaming CSA for infringing on Congress' decision-making authority since only Congress provides the funding for CSA's programs.

• Item: "Preliminary hearings led to a pretrial settlement between CSA and plaintiffs."

Response: The hearing at which Judge Grady in Chicago, Illinois concluded that plaintiffs were entitled to judgment was not

ATTACHMENT B

preliminary; there was no pretrial settlement between the parties. Rather, only after the submission of all memoranda and a hearing on the parties' respective motions for final judgment, was settlement reached.

° Item: ". . . no attempt was made to identify 'all others similarly situated' — the poor on whose behalf the class action was instituted. CSA rationalizes this deliberate oversight . . ."

Response: This option would not have been an effective method to alleviate the burden of rising fuel prices on the poor. The decision not to engage in a generally futile try to identify those people who were denied benefits or discouraged from applying nearly a year ago was no oversight. The obvious difficulty inherent in this alternative was recognized by the Court during the January 4, 1980 hearing:

How are we going to find out which persons were chilled from applying because of knowledge of this shutoff notice requirement? How are we going to gather the facts on which persons, other than your named plaintiffs, were turned down on that account in the region? We could spend the 15 million dollars gathering the facts in this case. I say that facetiously, but by the time we find them, it will be another year down the road and then we would be in the '81 program before we decided who was actually entitled to any money? Is it worth it?

° Item: "CSA sought a settlement which would allow it to use the funds to finance pet projects which otherwise might have been terminated because of opposition or a lack of interest in Congress."

Response: If this charge means that CSA adopted a posture in settlement negotiations designed to provide continued funding to projects authorized under its Act which had demonstrated success in developing innovative responses to the energy crisis, then CSA pleads guilty to funding "pet projects." Legal Services, Head Start, Weatherization and vendor energy payment programs are other "pet projects," first developed by CSA and later spun-off to more permanent homes in other federal agencies. CSA views the projects contemplated under the settlement as

fully meeting the Congressional purpose of CSA assisting innovative programs whose purpose is to alleviate the burden of rising fuel prices on the poor.

° Item: ". . . \$4 million will go to a hypothermia program run by former CSA grantees to alert people to the dangers of freezing to death."

Response: The program will be administered in fifteen northern states by current or new CSA grantees, not former grantees. It will do much more than simply alerting people to the dangers of freezing to death. It will provide 10,000 elderly households with a life-saving kit of special clothing, energy assessment of their homes, explanations of techniques for saving energy, and nutrition education. Although the United States has only recently become involved in studies concerning the devastating effect on the elderly when body temperatures drop below 90° F, Great Britain has determined that 10% of the aged there were susceptible to accidental hypothermia.

° Item: "\$1 million will be awarded to consulting firms and 15 Community Action Agencies, essentially to produce reports to inform us that energy is expensive."

Response: No money will go to explain that energy is expensive. In fact, these funds will go to community action agencies to enable them to become involved in comprehensive energy planning. The grantees will work in their communities on assessment and projecting energy uses and needs, developing conservation strategies, and lessening local dependence on outside energy sources, all with a focus on low-income people. Other funds will be used to do a comprehensive assessment of the impact of various energy costs on the poor. This assessment will then be used in on-going efforts to assure that energy policy at all governmental levels will be more responsive to the poor and elderly.

° Item: "Thus CSA and the public advocacy and legal services groups may have hit upon a marvelous recipe to render Congress's intentions moot and feather their own nests: leave money unspent, be sued and settle as thou and they can best profit."

Response: This implicit charge of collusion is extremely serious and very irresponsible. A reading of memoranda filed by CSA, represented by the Department of Justice, and the transcript of the hearing would leave no doubt that CSA presented a vigorous defense. Only after the court concluded that the plaintiffs were entitled to judgment did CSA enter settlement negotiations. It is ironic that government attorneys who during the Watergate era were criticized for defending illegal government acts to the end, are now criticized for settling once a court decides that a federal agency violated the law.

Plaintiffs' attorneys certainly did not "feather their own nests." No attorneys fees were awarded. The only monies they received from the court settlement were \$15 for filing fees and \$225 for printing costs. None of the attorneys are expected to participate under the terms of settlement as beneficiaries or employees of organizations receiving funds under the settlement.

CSA did not "leave money unspent." All of CSA's appropriation was expended in grants made to over 900 community groups. These groups, in some instances, did not commit all their funds prior to June 30, 1979. There was no "marvelous recipe." CSA lost in litigation over whether CSA had followed Congressional intent; and pursuant to the Court ordered settlement, plaintiffs' class will benefit from the disbursement of these funds.

° Item: "Assuming CSA could have won the case, fiscal responsibility would seem to demand that it do so and return the \$18 million to a government already under attack for excessive spending."

Response: Assuming CSA could have won the case, it would have done so. The author creates the impression that CSA should have been able to prevent the expenditure of the funds remaining in the program. The history of the litigation proves otherwise. Judge Grady found that the plaintiffs were entitled to judgment. Having concluded that CSA had lost the lawsuit, he urged the parties to reach settlement consistent with his remarks. Thus, regardless of the terms of settlement, CSA would be required by Court Order to expend the bulk of the remaining approximately \$18 million.

° Item: ". . . shouldn't the funds have at least been used for the purpose for which they were intended — to alleviate the burden of rising fuel prices on the poor — . . ."

Response: The funds are being used for that purpose. Both direct and indirect assistance alleviate energy burdens. Direct assistance pays one bill, one time. Indirect assistance, such as weatherization or advocacy leading to "lifeline" and other reduced rates, provides greater and more permanent alleviation. CSA's enabling legislation mandates CSA to attempt more permanent solutions and current Administration and Congressional policy is to leave payment programs to agencies such as the Department of Health and Human Resources.

° Item: CSA is a "floundering agency."

Response: Again, the author's choice of colorful adjectives is unsupported by her article. CSA continues to have Congress increase its appropriations, even in a time of cuts for domestic programs. CSA's efforts are hardly floundering, particularly in the energy area. It was CSA that first funded weatherization on a small scale, then received funds to demonstrate its success nationally, and saw it spun off to a permanent home in the Department of Energy with a five-fold increase by Congress. It was CSA that Congress chose to develop a national vendor payment program for the winter heating costs of the elderly and poor. That program grew from 200 million to ten times that amount and will find a permanent home this year in the Department of Health and Human Resources (HHS). During last winter's energy crisis program, the states were offered the choice of using CSA regulations and CSA grantees or operating through their own agencies. The vast majority chose to operate under CSA regulations and to use CSA grantees. When hundreds of elderly began to die in this summer's heat crisis, it was CSA that used its statutory flexibility to immediately provide financial assistance to communities seeking to help the poor and elderly. Congress not only sanctioned CSA's efforts, it passed emergency legislation substantially increasing CSA's authority to shift funds to meet the crisis.

APPENDIX 2(C)



LEGAL SERVICES CORPORATION
733 Fifteenth Street, N.W., Washington, D.C. 20005

Writer's Direct Telephone
(202) 272-4040

Dan J. Bradley
President

March 9, 1981

The Honorable M. Caldwell Butler
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Butler:

I am writing in further response to the questions you raised at the oversight hearing on the Legal Services Corporation (Corporation) held last week by the House Judiciary Subcommittee on Courts, Civil Liberties and the Administration of Justice. You asked a number of questions about the recent General Accounting Office (GAO) report, entitled "Disappointing Progress in Improving Systems for Resolving Billions in Audit Findings", and requested a full explanation of our response to the alleged deficiencies in the Corporation's auditing procedures.

I am pleased to have this opportunity to provide you with the additional insight into the Corporation's audit program that you requested.

GAO conducted this review to determine if federal executive agencies had improved their systems to resolve audit findings in accordance with policies of the Office of Management and Budget (OMB) Circular No. A-73. As you know, the Corporation is not a department, agency or instrumentality of the federal government. By law, OMB's authority over the Corporation's activities is limited to reviewing and commenting upon the Corporation's annual budget request to Congress. Nevertheless, the Corporation is more than willing to cooperate fully with the GAO in this endeavor.

The information presented in GAO's report concerning the Corporation's audit procedures appears to be based solely upon the Corporation's letter and memo (see Exhibit I) to Mr. Melvin J. Koenigs dated May 30, 1980, and a subsequent telephone conversation between the Corporation's Director of the Audit Division and a representative of GAO. A representative of GAO did not at any time visit the Corporation's Audit Division or directly examine our audit procedures.

BOARD OF DIRECTORS — Hillary Rodham, Chairman, Little Rock, Arkansas

Steven L. Engelberg
Washington, D.C.

Cecilia D. Esquer
Phoenix, Arizona

Michael Kanior
Los Angeles, California

Robert J. Kutak
Omaha, Nebraska

F. William McCalpin
St. Louis, Missouri

Revlus O. Orlique, Jr.
New Orleans, Louisiana

Howard R. Sachs
West Hartford, Connecticut

Ramona Shump
Topeka, Kansas

Richard Trudell
Oakland, California

Josephine Worthy
Holyoke, Massachusetts



LEGAL SERVICES CORPORATION

The Honorable M. Caldwell Butler
March 9, 1981
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I should also point out that the reporting format and information parameters used by GAO did not enable GAO to incorporate information that is both relevant and essential to our audit program, but may not be directly relevant to OMB Circular A-73 or the objectives of the GAO report. As a result, the conclusions on the Corporation's audit program that might be reached by a reader of the GAO report could understandably be negative.

I believe it more appropriate to base overall conclusions on the Corporation's audit program on a more in-depth understanding of what is involved in our audit program. I will, of course, send you a copy of our response to Congressman Brooks' request for our comments on GAO's observations. The Corporation's audit division has recently requested more information on certain aspects of the GAO report. A copy of that request is enclosed for your information. In the meantime, I will attempt to provide you with an overall perspective on the Corporation's audit program which should assist you in making an assessment of the effectiveness of this program.

CHRONOLOGY OF AUDIT PROGRAM DEVELOPMENT

1975/1976 -- Development of LSC's "Audit and Accounting Guide for Recipients and Auditors" and Conduct of Related Training Sessions

The Corporation issued its Audit Guide in August 1976 to insure that recipients and their auditors understood the accounting, reporting and auditing requirements for contracts and grants entered into with LSC. The Audit Guide was developed jointly by the Corporation and Arthur Andersen & Co., an international CPA firm, to reflect generally accepted accounting principles and auditing standards appropriate for non-profit organizations. The Audit Guide establishes the Corporation's accounting and auditing policies which govern annual financial audits. It requires each recipient to conduct an annual independent audit and to submit such audit to the Corporation within ninety days of the fiscal year end.



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The Honorable M. Caldwell Butler
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As a follow-up to the issuance of the Audit Guide, LSC conducted nine regional training sessions between September and December, 1976, to orient the programs to the requirements of the Guide. Each program's executive director, accountant/bookkeeper and chairperson of the board of directors were requested to attend.

1977 -- Development of LSC's "Accounting Model for Recipients"

As an outgrowth of the training sessions on the Audit Guide, LSC developed and distributed to all programs the "Accounting Model for Recipients" in March of 1977. This Model was developed in recognition of the fact that many programs needed further specific guidance in the financial management area to effectively identify and implement improvements.

1977 to the Present -- Evolution of LSC's Financial Mangement Improvement Program

The Corporation, during its long-term planning process, identified as a priority a commitment to insure that certain standards of performance in the financial area are met by programs. Pursuant to this commitment, LSC developed its Fundamental Criteria of an Accounting and Financial Reporting System for LSC Recipients (see Exhibit V). The Fundamental Criteria are a codification of the basic elements included in the Audit Guide and Accounting Model. The criteria are presented in a format which enables executives with nonfinancial backgrounds (usually program directors and board members) to clearly understand their stewardship responsibilities and accordingly, it assists them to appropriately discharge them.

The Fundamental Criteria were presented at nine regional training sessions to program directors and board members (with accounting personnel in attendance) to introduce them to the financial management standards that would be applied to programs on a nationwide basis. Attendees were advised that the Corporation would conduct a follow-up program to help insure that the requisite financial management capabilities exist at each field program.

During FY 1979 and FY 1980 the Corporation began a series of independent program reviews to assess recipient progress in complying with the Fundamental Criteria. To date we have completed approximately 200 of these reviews. The follow-up reviews identify



LEGAL SERVICES CORPORATION

The Honorable M. Caldwell Butler
March 9, 1981
Page Four

occasions when programs have failed to upgrade their accounting and reporting capacities in accordance with the fundamental criteria and the review results in a requirement for the preparation of a work plan to do so. We require status reports from recipients' independent auditors indicating the progress being made by the programs. Monitoring offices exert substantial administrative pressures to insure that program directors meet our standards for financial management.

The Corporation's current activities represent the final stages of a three-year plan under which the Audit Division has been operating. We are in the planning stages of our follow-up three-year plan, and hope to be in a position to finalize its elements shortly.

COMMENTS ON AUDIT PROGRAM EFFECTIVENESS

During his testimony on the GAO report before the House Government Operations Committee, Comptroller General Staats indicated that, in his opinion, the lack of internal controls at recipient organizations was the major cause for the audit area to be in the condition reflected by the GAO report. I should point out that OMB Circular No. A-73 does not address remedying this lack of controls -- the basic cause of the dilemma, according to Mr. Staats.

The A-73 approach is essentially retrospective. In contrast, the Corporation's audit approach, as indicated above, heavily emphasizes upgrading of internal controls at the recipient level through the monitoring and Financial Management Improvement Program.

We believe our results to date have been encouraging. For example, during the approximate period of the GAO study (FY 1978 and FY 1979), the Corporation awarded grants and contracts of \$190,416,181 in 1978 and \$250,520,031 in 1979, a 32% increase. Of these awards, costs of \$845,187 in 1978 and \$638,463 in 1979 were questioned. Those amounts represent 0.44% and 0.25% of total awards, respectively. We experienced a 25% decrease in costs questioned between FY 1978 and FY 1979, although OUF funding and the number of recipients supported increased significantly. We expect that trend to continue for 1980. The actual figures for 1980 are not available since the majority of the 1980 audits are not due until the end of March, 1981. The Corporation's response



LEGAL SERVICES CORPORATION

The Honorable M. Caldwell Butler
March 9, 1981
Page Five

to Congressman Brooks will include an analysis of the nature of these costs. Since costs are questioned for technical as well as substantive reasons, the distinction provides additional insight into our recipients' management of public funds.

In contrast to the Corporation's experience between 1978 and 1979, the GAO report indicates that unresolved questioned costs at the 34 agencies surveyed in 1978 increased from \$4.3 billion to \$14.3 billion. The related fiscal periods may not exactly coincide with FY 1978 and FY 1979; however, the increase noted exceeds 232%. Although the Corporation's unresolved costs increased 45 percent, our approach appears to have significantly out-performed the composite agency results.

As a general rule most agencies require audit reports to be submitted by recipients six months after the fiscal year-end. The Corporation requires its recipients to submit audits 90 days after the fiscal year end. We are also testing a procedure whereby the Corporation will essentially take over the audit responsibilities of a recipient whose history of delinquent audits warrants such an extreme action. There is no requirement for such a procedure in OMB Circular No. A-73; nor am I familiar with comparable federal guidelines for any federal program.

I remain confident that a comprehensive, objective look at our audit program will confirm that it has been effective, although we must continue to seek improvements.

SPECIFIC GAO AND COMMITTEE CONCERNS

I understand the two major concerns affecting audit performance identified by GAO at the hearing conducted by the House Government Operations Subcommittee on Legislation and National Security were that:

- (1) Agencies lacked adequate mechanisms to track questioned costs from the time identified to final resolution; and
- (2) Agencies were not resolving questioned costs in a reasonable (six months) amount of time.



LEGAL SERVICES CORPORATION

The Honorable M. Caldwell Butler
March 9, 1981
Page Six

Prior to May 1980, the Corporation's Audit Division procedures provided for follow-up through final disposition only when the magnitude or nature of the costs would warrant such follow-up. These procedures did not alter the fact that our monitoring office directors were responsible for resolving all such costs. Beginning in May 1980, the Corporation's Standard Operating Procedures were changed to require the Audit Division to follow-up, through final disposition, on all questioned costs. The procedures now in place are adequate to track all questioned costs from the time identified to final resolution. I am confident that our revised procedures fully address the first major concern noted above.

The Corporation has also enhanced its procedures to insure that questioned costs are resolved within a reasonable time frame. The Director of the Audit Division currently provides the Corporation's Director of Field Services and the Vice President for Finance and Management with a report every two months on questioned costs by recipients. This report indicates the status and age of all unresolved questioned costs. The Director of Field Services supervises the regional directors who are responsible for resolving questioned costs for the majority of our recipients. I have instructed the Director of the Audit Division to provide me with a copy of the questioned cost report beginning with the report due March 16, 1981. I have also instructed the Audit Division Director to provide me, monthly, with a copy of the Audit Division's report of delinquent audits. That report initially had the same distribution as the report on questioned costs.

Other issues of particular concern to you at the hearing and my related comments follow:

- (1) System Excludes Some Findings and Reports -- GAO indicated that our reporting excluded some findings and reports. This comment was accurate at the time GAO made it, as I described above. Our procedures required direct follow-up by the Audit Division to final disposition only on certain items. Beginning in May 1980, the Corporation modified its procedures to require the Audit Division to follow up, through final disposition, whenever a questioned cost is involved. No cost findings are excluded from our current reporting process.



LEGAL SERVICES CORPORATION

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Page Seven

We do not attempt to include all procedural findings in this reporting process. As our audit procedures have evolved, we have found that this requirement could quickly become a paper avalanche, with process quickly supplanting substantive results. We believe our monitoring and Financial Management Improvement Program (FMIP) and the audit approach documented above more effectively address this area.

- (2) Some Evidence of Premature Closure -- This comment indicates GAO found audit reports were closed before audit questions were resolved. We have no information that would indicate on what facts this finding is based. The time frame of my response to you precludes thorough follow-up with GAO. Therefore, under these circumstances, it would not be appropriate to refute this finding at this time. However, our audit approach does not define an audit as an absolute open or closed. Specific issues may be resolved and closed. Our emphasis is on the issues needing resolution, and our Standard Operating Procedures provide the means to address our objective. The Corporation's Audit Division has written to GAO to secure more information on this item. (See enclosed letter.) With more specific information, we can be more responsive in our comments to Congressman Brooks.
- (3) Inadequate Accounting or Collection Controls -- This comment appears to indicate that GAO found a loss of accountability of amounts due to the Corporation. We have consistently advised the Corporation's Comptroller to record as an account receivable amounts which would be potentially returned to the Corporation; and we are not aware of any circumstances in which accountability was lost for amounts due the Corporation. In addition, such amounts and other amounts which may be resolved without being returned to the Corporation are accounted for on the Audit Division's report on questioned costs. Again, we have requested more specific information from GAO and will attempt to implement any suggestions the GAO can offer to improve our current procedure.



LEGAL SERVICES CORPORATION

The Honorable M. Caldwell Butler
March 9, 1981
Page Eight

- (4) No Written Decisions Within Six Months -- We do not have a specific time frame within which audit findings must be resolved. We have a mechanism in place, as I described above, which top management can utilize to insure the time frame for resolution of questioned costs and other audit issues is kept reasonable.
- (5) No Assurance that Resolution is Consistent with Laws and Regulations -- The only assurance we are relying on for resolution of questioned costs, at present, is the knowledge and judgment of the monitoring office director, notice of the resolution to the Audit Division Director, and consultation with our General Counsel, as required. We believe our current procedures are reliable. We have, however, requested suggestions from GAO to address the deficiencies it believes exists.
- (6) Auditor Program Office Disagreements not Elevated after Six Months -- This comment refers to the fact that we have no formal documented provision for resolving, at a higher level, potential disputes between audit and monitoring office personnel. Our experience so far has been that the regional directors often seek Audit Division advice with respect to resolution of unusual audit issues. Such issues are often discussed among the Vice President for Finance and Management, the Director of the Office of Field Services, and the Audit Division Director. However, our procedures do not include a formal provision to refer disagreements to a higher authority after six months. We agree that the Corporation should formalize an effective mechanism to resolve any impasse that might arise between the Audit Division and monitoring office directors.
- (7) No Semi-Annual Reports to President -- Presently the Vice President for Finance and Management and the Director, Office of Field Services, receive the questioned cost and audit delinquency reports prepared on a recurring basis by the Audit Division. These reports will also be sent to me beginning with the reports due in March.



LEGAL SERVICES CORPORATION

The Honorable M. Caldwell Butler
March 9, 1981
Page Nine

- (8) No, or Inadequate, Procedures for Coordinating Corrective Actions -- The GAO report does not allege a deficiency in this area. It indicates that a determination as to what we do was not made by GAO. Our Audit procedures (see Exhibits II, III and IV) document the extent to which the Audit Division and the monitoring offices coordinate corrective actions. The Corporation's Financial Management Improvement Program also demonstrates our approach to coordination in audit and financial management matters.

It is difficult to present an adequate sense of our audit program in a document of this length. However, I think these comments will provide valuable perspective to add to GAO's report. I have included the following list of exhibits to provide you with additional details of relevant areas of our audit program if desired:

Exhibit I - Letter and memo to Mr. Melvin J. Koenigs dated May 30, 1980. (Primary source for GAO's comments on LSC included in GAO's January 23, 1981, report "Disappointing Progress in Improving Systems for Resolving Billions in Audit Findings").

Exhibit II - Comptroller's Office Standard Operating Procedures relating to Recurring Recipient Audits. (Note: This procedure will be revised to reflect the Audit Division procedural changes in May 1980 referred to in the body of this letter. You will receive the revised copy in conjunction with my comments requested by Congressman Brooks.)

Exhibit III - Comptroller's Office Standard Operating Procedures relating to New Recipients.

Exhibit IV - Comptroller's Office Standard Operating Procedures relating to Termination Audit Reports.

Exhibit V - Fundamental Criteria of an Accounting and Financial Reporting System for LSC Recipients. (Represents in summary form the financial management standards expected of the Corporation's recipients).



LEGAL SERVICES CORPORATION

The Honorable M. Caldwell Butler
March 9, 1981
Page Ten

Exhibit VI - LSC's "Audit and Accounting Guide for Recipients and Auditors"

NOTE: In September 1980, I elevated the audit function to Division status to reflect the significance the Corporation attaches to its stewardship responsibilities. As revised audit Standard Operating Procedures are issued, they will be issued from the Audit Division.

I hope these comments are responsive to your concerns. As I have indicated, our approach is not one typically followed by government agencies. However, we intend to take advantage of any suggestions the GAO can make to strengthen our audit program.

We believe that OMB Circular No. A-73 does not preclude innovative approaches to the audit area when positive results can be demonstrated. We will continue to combine the traditional with innovative audit procedures which will result in the most effective management of public funds.

Sincerely,

Dan

Dan J. Bradley

Attachments

cc: The Honorable Robert W. Kastenmeier
The Honorable Thomas F. Railsback

L.S.C. EXHIBITS ON AUDIT ISSUE

EXHIBIT I



LEGAL SERVICES CORPORATION
733 Fifteenth Street, N.W., Washington, D.C. 20005

Don J. Bradley
President

Writer's Direct Telephone
(202)

May 30, 1980

Mr. Melvin J. Koenigs
U.S. General Accounting Office
Chicago Regional Office
230 South Dearborn, 16th Floor, West
Chicago, IL 60604

Dear Mr. Koenigs:

We have enclosed the information relating to the Legal Services Corporation's (the Corporation's) audit efforts which had been requested by Mr. Frank Mikus in his letter of April 14, 1980. The information was requested pursuant to the General Accounting Office's (GAO's) review to determine if Federal executive agencies have improved their systems to follow-up and resolve audit findings in accordance with policies of the Office of Management and Budget (OMB) Circular No. A-73.

The Corporation is not considered a department, agency, or instrumentality of the Federal Government. Consequently, OMB's authority over the Corporation's activities is limited to reviewing and commenting upon the Corporation's annual budget request to Congress. Nevertheless, we do feel that we have an audit program that responds to OMB's objectives and we are happy to provide the GAO with the enclosed requested information.

Sincerely,

Patrick J. Yogus
Patrick J. Yogus
Audit Manager

PJY/pmb

cc: Gerry Singsen, Vice President for Finance and Management
Clint Lyons, Director, Office of Field Services
Regional Directors



LEGAL SERVICES CORPORATION
733 Fifteenth Street, N.W., Washington, D.C. 20005

Don J. Bradley
President

Writer's Direct Telephone
(202)

MEMORANDUM

DATE: May 30, 1980

TO: U. S. General Accounting Office
Chicago Regional Office
230 South Dearborn, 16th Floor West
Chicago, IL 60604
ATTN: Mr. Melvin J. Koenigs

FROM: Patrick J. Yogus,
Audit Manager, Legal Services Corporation

SUBJECT: RESPONSE TO GENERAL ACCOUNTING OFFICE DATA REQUEST

ITEM I--AUDIT PROGRAM RESPONSIVENESS TO APPLICABLE SECTIONS OF OMB
CIRCULAR No. A-73.

Applicability and Scope

The Corporation is not an agency of the executive branch of the Federal Government and thereby is not covered by the provisions of OMB Circular No. A-73. However, we believe our audit program, which has been tailored to respond to our specific needs, also responds to the objectives of OMB Circular No. A-73.

2. Definitions

- a. The term "audit" as used in conjunction with the Corporation's audit program means a systematic examination to determine whether:
 1. The financial statements fairly present the recipient's financial position and results of operations in accordance with generally accepted accounting principles applied on a consistent basis with the preceding period.



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2. The accounting system and related internal controls of the recipient are operating effectively and adequate records are being maintained.
3. Costs incurred are reasonable, applicable to the legal assistance program, and eligible under the Corporation's requirements.
4. The recipient has complied with the accounting terms and conditions of the grant or contract.

The Corporation's audit requirements include financial compliance items, and economy and efficiency elements to the extent that objective judgements can be made in this area based upon the reasonableness and eligibility of costs incurred. Economy, efficiency, and program results are more specifically addressed by monitoring teams from the Corporation's regional/monitoring offices. The nature of the activity of delivering legal services dictates that subjective judgements, when required, relating to economy, efficiency, and program results should be made by individuals with heavy experience in the actual delivery of legal services. The typical independent auditor does not have such experience. Therefore, the Corporation has not required such judgements to be made in the context of the annual audit.

- b. Audits are conducted in accordance with generally accepted auditing standards with the scope of work being sufficient to allow the auditor to respond to the four points noted in 2.a. above.

3. Policies and Procedures

The Corporation has issued an "Audit and Accounting Guide for Recipients and Auditors" (Audit Guide) to implement its audit policies and provide guidance to auditors and recipients. We have developed the Corporation's "Fundamental Criteria of an Accounting and Financial Reporting System for LSC Recipients." These criteria, coupled with the Corporation's Financial Management Improvement Program (FMIP) are designed to assure that an adequate level of financial management capabilities exists at each of the Corporation's recipient programs.



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The Corporation has also developed formal written policies, plans, and procedures which assign responsibilities and guide our own internal procedures.

a. Organization and Staffing

The Corporation's Audit Department is located outside the program management structure. The Audit Manager reports directly to the Vice President for Finance and Management, who in turn reports directly to the President. The Audit Department is authorized seven professional staff. Qualifications include attainment of the CPA certificate and sufficient public accounting experience to be fully competent in conducting and reviewing audits of our recipients. Our standard operating procedures have established close coordination between the audit function and the program management activities that are the responsibility of the regional/monitoring offices.

b. Determination of Audit Priorities

Each recipient is required to be audited annually within 90 days of its fiscal year-end. That audit requirement applies to all recipients who are awarded grants and contracts under Section 1006(a)(1)(A) of the Legal Services Corporation Act as Amended 1977.

All new recipients, or recipients having experienced substantially changed conditions, must undergo an evaluation of their accounting and reporting systems to ensure that such recipients have the capabilities to account for and safeguard the funds awarded to them by the Corporation prior to expending significant amounts of those funds.

c. Cross-Servicing Agreements

The Corporation utilizes independent certified public accountants to conduct the majority of its required audits. However, we have utilized Federal auditors when that option provided the most efficient basis for accomplishing the audit requirement. We have



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formally coordinated with the Community Services Administration, in particular, to ensure the most effective audit approach of jointly funded recipients.

The Corporation's Audit Guide requires every effort be made to satisfy the audit needs of all funding organizations with one annual audit report. When a single audit is not acceptable to all funding sources, the recipient's executive director must contact the Corporation in an attempt to work out an agreeable arrangement for carrying out the required audits on the most efficient basis.

d. Reliance on Non-Federal Audits

(See 3.c. above for policies relating to reliance on Non-Federal auditors.)

e. Audit Plans

Each year, the Audit Department prepares a memorandum to document the broad policies which will be followed during the next several fiscal years in conducting its activities. The memorandum identifies:

- The areas that we considered our major priorities;
- All of the tasks that are necessary to adequately discharge the responsibilities associated with each priority;
- The impact that various resource allocation decisions will have upon our capabilities to cover all the tasks associated with satisfying our priorities.

f. Coordination of Audit Work

As discussed in (3.c.) above, the Corporation strongly pursues the single audit concept.



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g. Audit Reports

Audit reports of our recipients are submitted to the Comptroller General of the United States in accordance with the requirements of the Legal Services Corporation Act as Amended 1977. Copies of such reports are maintained for a period of five years at the Corporation and the release of such reports to the public complies with the Freedom of Information Act.

h. Follow-up

The duties and responsibilities related to follow-up procedures are fully documented in the Corporation's Standard Operating Procedures Relating to Recurring Recipient Audits. Our procedures are geared to correcting the fundamental causes of audit problems rather than attempting a symptom by symptom remedy.

The Corporation does not have the resources to respond specifically and immediately to each comment included in an audit report. Therefore, we have developed an organized, coordinated approach to ensure our efforts are directed toward the most effective activities. Our follow-up procedures are designed to remedy the causes of deficiencies noted over the long-term, rather than attempt to address the audit report as an isolated event. The required response to audit deficiencies is determined in conjunction with evaluating the past history of a program's performance in the financial management area.

As an integral part of audit follow-up, the regional/monitoring office staff make frequent monitoring visits, and visits in conjunction with the Corporation's Financial Management Improvement Program. Audit related deficiencies in some programs can be corrected immediately. In other programs, adequate responses to audit deficiencies may demand a complete change in management style to ensure appropriate attention is given to the financial management area. The Corporation's preferred technique in addressing financial and other operating deficiencies is to provide technical assistance and training to remedy the deficiencies. However, various other



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responses including defunding of the program are available to the Regional Directors when less drastic actions cannot effect the required changes.

The regional/monitoring offices and the Audit Department work closely together on a continuing basis to ensure that the audits of our recipients are of the highest quality and financial management deficiencies are ultimately eliminated. Our follow-up procedures recognize the limitations of our own resources, but also ensure the accomplishment of our objectives over the long term.

ITEM II--INFORMATION ON AUDIT REPORTS FOR THE YEAR ENDED DECEMBER 31, 1979

- A. There have been no internal audit reports issued by the Audit Department on the operations of the Legal Services Corporation. All audit resources have been allocated to recipient audits. Such an allocation will continue for the foreseeable future.
- B. 1. Volume of financial statement audit reports issued by independent certified public accountants to date for the year ended December 31, 1979 263
- 2. Associated questioned costs \$616,428
- C. Volume of independent reviews conducted in accordance with the Corporation's FY 1979 Financial Management Improvement Program:
 - 1. By Corporation audit staff 30
 - 2. By independent consultants reporting directly to the Corporation 48
- D. Volume of initial evaluations (analogous to pre-award audits) conducted by independent certified public accountants during the year ended December 31, 1979 15



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ITEM III--RESOLUTION OF AUDIT FINDINGS FOR THE YEAR ENDED DECEMBER 31, 1979

- A. As noted in ITEM II.B.2. above, total costs of \$616,428 were questioned by auditors for the year ended December 31, 1979. The Corporation's audit guidelines require that recipient audit reports be submitted to the Corporation 90 days after their fiscal year-end -- March 31, in most cases. The costs questioned on the audit reports for December 31, 1979, will be addressed by the appropriate directors and resolved subsequent to March 31, 1980. Normally, a resolution process cannot begin prior to late April or early May of the following year, at the earliest.

The responsibilities for resolving questioned costs are defined and assigned in the Corporation's Standard Operating Procedures Relating to Recurring Recipient Audits. Occasionally, questioned items will be complex and the resolution will require the appropriate director to initiate a process to resolve the issues in a fair and equitable manner. In these cases, questions will remain open until the process has been completed.

ITEM IV--AGED ANALYSIS OF AUDIT REPORTS WITH QUESTIONED COSTS PENDING RESOLUTION AS OF DECEMBER 31, 1979

The Audit Department files on recipient audits are maintained by calendar year, therefore the aging categories requested are not available without substantial analysis of the files. However, the information we have provided by calendar year should satisfy the objectives of your request:



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ANALYSIS OF QUESTIONED COSTS

	<u>Y/E</u> <u>1979</u>	<u>Y/E</u> <u>1978</u>	<u>Y/E</u> <u>1977</u>	<u>Y/E</u> <u>1976</u>	<u>Total</u>
No. of reports received:	263	331	297	241	1,132
Reports with questioned costs:	40	56	54	49	199
Dollar value:	\$616,428	\$845,187	\$585,246	\$426,406	\$2,473,267
No. of reports resolved:	8	12	24	18	62
Dollar value resolved:	\$ 19,305	\$ 59,321	\$330,306	\$ 96,418	\$ 505,350
No. of open reports:	32	44	30	31	137
Dollar value open:	\$597,123	\$785,866	\$254,940	\$329,988	\$1,967,917

The table includes all costs that have been questioned by auditors both for technical and substantive reasons. For audit purposes, costs are designated as open if the resolutions of the questions has not been documented in the applicable offices' files. Costs which have been informally resolved will be designated as open until the resolution has been adequately documented. Meaningful conclusions regarding the analysis of Questioned Costs can only be made in conjunction with a further analysis of the type, nature, and circumstances surrounding the individual questions.



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ITEM V--ACTUAL/BUDGETED COST OF THE AUDITING FUNCTION

In FY 1979, the Corporation spent \$156,661 on its own staff of internal auditors, \$420,114 acquiring the services of independent certified public accountants and consultants, and \$116,650 for training expenses of recipients and staff related to the Corporation's audit and FMIP activities. During FY 1979, the Audit Department and Accounting Department were combined in the Corporation's accounting records under the Comptroller's Office. The costs noted resulted from analysis of total Comptroller's Office expenses for FY 1979 and include allocations where appropriate.

The Corporation has budgeted \$335,803 for FY 1980 for its own staff of internal auditors and \$479,829 for acquiring the services of independent certified public accountants and consultants for audit and FMIP activities.

EXHIBIT II


LEGAL SERVICES CORPORATION
MEMORANDUM

DATE: April 9, 1979

TO: OFFICES WITH PROGRAM MONITORING RESPONSIBILITY (Office of Field Services, Office of Program Support, Delivery Systems Study, Quality Improvement Program)

FROM: Fabio de la Torre, Comptroller

SUBJECT: COMPTROLLER'S OFFICE STANDARD OPERATING PROCEDURES RELATING TO RECURRING RECIPIENT AUDITS.

Section 1009(c)(1) of the Legal Services Corporation Act as amended 1977 states:

"The Corporation shall conduct, or require each grantee, contractor, or person or entity receiving financial assistance under this title to provide for an annual financial audit...."

The purpose of this memo is to define responsibilities and objectives, and to update and supercede the related standard operating procedures defined in my memo of April 25, 1977. These procedures are designed to allow the Comptroller's Office and the monitoring offices to adequately discharge their audit-related responsibilities.

The procedures set forth in this memo attempt to establish guidance to assist the monitoring offices and the Comptroller's Office in discharging their respective responsibilities in a specific area--recurring recipient audits. I will appreciate any comments or suggestions you have which will lead to a more effective program.

OBJECTIVES

The mutual objectives of the monitoring offices and Comptroller's Office with respect to recipient audits are:

1. Quality Audits:

Ensure that annual audits of recipients are carried out effectively, efficiently, in accordance with LSC guidelines, on a timely basis, and that LSC's responsibilities to the Comptroller General of the United States as required by Section 1009(c)(2) of the Legal Services Corporation Act as amended 1977 are met.

2. Adequate Financial Management:

Establish follow-up procedures which will ensure effective action has been taken to resolve financial reporting deficiencies, accounting deficiencies and/or operational deficiencies noted in audit reports and prevent their recurrence.

BACKGROUND

LSC requires that each recipient submit an annual audit report and auditor's supplemental letter to the Corporation within 90 days of the recipient's fiscal year-end. The annual audit report and supplemental letter must be completed in accordance with provisions in LSC's *Audit and Accounting Guide for Recipients and Auditors*.

If audit reports are received from recipients within the requested time frame, the information contained therein is still 3 months old and may or may not continue to be relevant at the time of LSC's receipt, review and response to the audit. If extensions for submission of the audit are granted or audit reports are submitted late without permission, the information becomes increasingly stale. Approximately 60% of LSC's recipients have fiscal years ending 12/31; 15% have fiscal years ending 6/30; and 25% have fiscal years spread relatively evenly over the remaining 10 months. Because of these timing and other considerations, LSC does not have the physical capacity to review and comment upon each of the audit reports immediately. Because our resources are limited, we must ensure our efforts (Comptroller's and monitoring offices') are being directed toward the most effective activities.

After considering the circumstances, it is apparent that the receipt of an audit report cannot be perceived as an isolated event that must precipitate specific and immediate responses from LSC in order to demonstrate that LSC is fulfilling its stewardship responsibilities. To illustrate the ineffectiveness of dealing with audit reports as isolated events; consider that normally all of LSC's recipients with December 31 fiscal year-ends will be refunded before the audit report for the prior fiscal year is even due. In addition, adequate responses to audit deficiencies in some programs may demand a complete change in management style from that of laissez-faire to one of adequate attention to financial management and control techniques. Such a change cannot be accomplished by a memo requesting corrective action. Our procedures must recognize these realities, but also, must ensure the accomplishment of our objectives over the long-term. As such, we must attempt to ensure that the audits of our recipients are the highest quality and financial management deficiencies are ultimately eliminated. Both the monitoring offices and the Comptroller's Office must work together in accomplishing both of these goals.

The following procedures, we believe, are an effective and realistic response to carrying out our respective responsibilities in the audit area.

PROCEDURES AND RESPONSIBILITIES	
AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>I. <u>Timeliness of Reports</u></p> <p>A. The Comptroller's Office can accept any 12-month fiscal period as the audit period, as long as that period is consistently used. The fiscal year-end should be the date that is most convenient for the recipient after considering such items as fiscal year required by the recipient's Corporate Charter or Bylaws; requirements of other funding sources; availability of prompt services from auditors; etc.</p> <p>B. The Comptroller's policy is that audit reports must be submitted to LSC within 90 days of the recipient's fiscal year-end. The Comptroller's Office will make no exceptions to that policy.</p> <p>C. The Comptroller's Office will maintain a control file for all recipients by which to monitor the timely submission of annual audit reports to LSC.</p> <p>By the 10th working day of each month, the Comptroller's Office will submit to each monitoring office director and Director of Field Services, a listing of those audit reports which are delinquent, the number of months delinquent, and a listing of those which will become due in the current month.</p>	<p>I. <u>Timeliness of Reports</u></p> <p>A. The monitoring office is responsible for authorizing changes in fiscal year-ends which are requested by the recipient to facilitate obtaining an optimal reporting date. However, no single audit report period may include over 18 months as a result of authorizing a change in fiscal year-end.</p> <p>B. The monitoring office director may authorize extensions of the 90-day time period for submission of audit reports for up to 60 additional days for reasons he considers to be valid. Extensions should not be granted to programs with a history of financial difficulties or audit problems. If timeliness is a chronic problem with a particular recipient, the monitoring office director should request the recipient to change its fiscal year to accommodate the 90-day requirement or suggest other alternatives that will preclude the perennial delinquency. The monitoring office director should notify the Audit Manager of any extensions granted.</p> <p>C. It is the monitoring office's responsibility to follow-up on the delinquent report listing to resolve the delinquency problems.</p>

PROCEDURES AND RESPONSIBILITIES	
AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>I. <u>Timeliness of Reports (Cont'd)</u></p> <p>D. If the audit reports are not received 60 days after the original due date or by the date authorized by extensions, the Comptroller's Office, in cooperation with the monitoring office, will initiate arrangements with auditors of its own choice to perform the audit. Within 10 working days of a recipient's audit report becoming 60 days delinquent, the Comptroller's Office will send the standard "Delinquency Follow-up Letter" (See RASOP--ATTACHMENT I) to the applicable director with carbon copies to Director of Field Services, monitoring office director, chairman of recipient's board of directors, and the selected auditing firm. Based upon the response to the letter the Comptroller's Office will coordinate the required follow-through with the recipient, the monitoring office, and the auditors.</p> <p>E. The Comptroller's Office will be responsible for notifying new or terminating recipients of LSC's initial and continuing audit requirements. See memo dated / /79, re: Comptroller's Office Standard Operating Procedures Relating to New Recipients; and memo dated / /79, re: Comptroller's Office Standard Operating Procedures Relating to Termination Audit Reports.</p> <p>II. <u>Adequacy of Reports and Operations</u></p> <p>A. <u>Initial Processing</u></p> <p>A member of the Comptroller's Office Audit Department will log-in and read each audit report and supplemental letter upon receipt. Audit</p>	<p>7. <u>Timeliness of Reports (Cont'd)</u></p> <p>D. The monitoring office will participate as required to ensure cooperation by the recipient.</p> <p>E. The monitoring office is responsible for advising the Audit Department of new programs/mergers/or other occurrences which would precipitate audit ramifications. The notification to the Audit Department must be made as early as possible so that all responsibilities can be discharged in a timely manner. (Refer to memo dated / /79, re: Comptroller's Office Standard Operating Procedures Relating to New Recipients, and memo dated / /79, re: Comptroller's Office Standard Operating Procedures Relating to Termination Audit Reports.</p> <p>II. <u>Adequacy of Reports and Operations</u></p> <p>A. <u>Initial Processing</u></p> <p>A member of the monitoring office (usually the regional management specialist) should read each audit report as it is received at the</p>

PROCEDURES AND RESPONSIBILITIES	
AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>A. <u>Initial Processing (Cont'd)</u></p> <p>reports identified during this initial reading as "obviously deficient" or "special audits" will be assigned priority in the desk audit review process. The criteria for an obviously deficient or special audit are as follows:</p> <ol style="list-style-type: none"> 1. Reports prepared by individuals other than independent certified public accountants or independent public accountants licensed on or before December 31, 1970. 2. Reports issued with a qualified opinion for reasons associated with lack of sound financial management capabilities such as failing to maintain adequate records. 3. Reports with opinions not covering all appropriate financial statements. 4. Reports issued that do not separately identify LSC support, expenses, and fund balances. 5. Reports which identify a significant fund balance excess or deficit. 6. Reports which identify significant operating deficiencies and/or questioned costs. 7. Reports which display sufficient non-compliance with LSC Audit Guide, Generally Accepted Accounting Principles (GAAP), or Generally Accepted Auditing Standards (GAAS), to cause the reviewer to question the overall quality of the audit. 8. Termination audit reports. 9. Reports identified as "priority" by Audit Manager or Comptroller for reasons of deficiencies or other reasons. 	<p>A. <u>Initial Processing (Cont'd)</u></p> <p>monitoring office to be aware of any significant deficiencies that can be identified by reviewing with no further analysis.</p> <ol style="list-style-type: none"> 1. N/A 2. N/A 3. N/A 4. N/A 5. N/A 6. N/A 7. N/A 8. N/A 9. N/A

PROCEDURES AND RESPONSIBILITIES	
AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>A. <u>Initial Processing (Cont'd)</u></p> <p>The relative nature of the deficiencies will determine the order in which the "obviously deficient" and "special audit" reports will be desk audited. At such time that all "obviously deficient" and "special audits" have been desk audited, the Audit Department will concentrate their desk audit procedures on the most recent audit reports received.</p> <p>B. <u>Processing Incomplete Reports</u></p> <p>Upon receipt of the audit report by LSC, the Comptroller's Office will directly notify the program director if the supplemental letter is not included in the audit report or if insufficient copies of the supplemental letter or financial statements are received. (RASOP--ATTACHMENT II.) A copy of this correspondence will be sent to the monitoring office. The Comptroller's Office will directly notify the recipient a second time, about two weeks after the first notification, with a copy to the monitoring office. (RASOP--ATTACHMENT III.) The third follow-up will be sent to the monitoring office with a copy to the program about two weeks after the second follow-up. (RASOP--ATTACHMENT IV.) The audit report will not appear on the delinquency list when insufficient copies are received or when a supplemental letter is not included.</p> <p>C. <u>Desk Audit Procedures</u></p> <p>1. <u>Desk Audit--General</u></p> <p>The desk audit of the audit report will be completed in accordance with LSC's Desk Audit Guidelines (RASOP--ATTACHMENT V) and will be documented on a standard "Desk Audit Documentation Form." The desk audit</p>	<p>A. <u>Initial Processing (Cont'd)</u></p> <p>B. <u>Processing Incomplete Reports</u></p> <p>The monitoring office will follow up as required to secure the required copies of audit reports and supplemental letters.</p> <p>C. <u>Desk Audit Procedures</u></p> <p>1. <u>Desk Audit--General</u></p> <p>The monitoring office will receive a copy of the "Desk Audit Documentation Form."</p> <p>The comments contained in the Desk Audit Documentation Form will</p>

PROCEDURES AND RESPONSIBILITIES	
AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>1. <u>Desk Audit--General</u> (Cont'd)</p> <p>comments will focus on major areas of concern regarding quality audits and financial management that should be addressed/resolved by the recipient, the auditors, the monitoring office, or the Comptroller's Office.</p>	<p>1. <u>Desk Audit--General</u> (Cont'd)</p> <p>attempt to focus only on the problems. The comments will not include comprehensive background materials and explanatory details to help clarify accounting issues or deficiencies that may exist. The comments will also not attempt to provide alternative approaches to resolving specific deficiencies noted in the audit reports. If any comments are not clear to the monitoring office, these comments should be discussed with the Comptroller's Office Staff.</p>
<p>Because of lag-time considerations which were described in the background section of this memo, follow-up procedures must be designed to remedy the cause of deficiencies noted over the long-term, rather than attempt to address the audit report as an isolated event. The required response to desk audit reviews must be determined in conjunction with evaluating the past history of the program's performance in the financial management area.</p>	
<p>2. <u>Follow-up Guidelines: Quality of Audits</u></p> <p>The Comptroller's Office is responsible to follow-up (through the monitoring offices) on all situations in which the audit report or supplemental letter does not comply with the LSC Act, LSC's Regulations, or LSC's <i>Audit and Accounting Guide for Recipients and Auditors</i> to a degree that exceeds all reasonable latitudes in enforcing the Act, the Regulations, and the Audit Guide. When an audit report cannot be accepted, the Comptroller's Office will advise the program director of the deficiencies and describe the actions necessary to remedy them. The correspondence will request the program director to respond to the Comptroller's Office within a specified time period. A copy of the correspondence</p>	<p>2. <u>Follow-up Guidelines: Quality of Audits</u></p> <p>Monitoring office's response will be apparent from the desk audit comments and the accompanying correspondence. The monitoring office will consult with the Comptroller's Office as required to resolve unacceptable audit reports.</p>

PROCEDURES AND RESPONSIBILITIES	
AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>2. <u>Follow-up Guidelines: Quality of Audits</u> (Cont'd)</p> <p>sent to the monitoring office and to the auditors. If no response is received on the date requested, a written follow-up will be made by the Comptroller's Office to the program director with copies to the auditors and monitoring office. The third follow-up notification will be sent directly to the monitoring office. For example, areas of required follow-up include, but are not limited to, the following (Professional judgement must be exercised in all circumstances):</p> <ul style="list-style-type: none"> - Auditor's ineligibility to perform LSC audits; - Audit reflects possible loss of accountability for LSC support or assets; - Audit reflects apparent gross misapplication or non-application of professional reporting standards, or gross non-compliance with appropriate guidelines. 	<p>2. <u>Follow-up Guidelines: Quality of Audits</u> (Cont'd)</p>
<p>Primary responsibility for action and follow-up on audit recommendations rests with the "management function" rather than the "audit function." "Management" is defined as both the officials responsible for the operations of each individual recipient program (board of directors, executive director, etc.) and LSC as the financial supporter of the nationwide legal assistance program (monitoring offices, Comptroller's Office, etc.). Provision must be made to assure that corrective actions and follow-up procedures are enacted. A good control system will include procedures under which management officials will evaluate the effectiveness of actions taken on audit recommendations.</p>	
<p>As was noted in the earlier "background" comments, even the most timely audit report is received by LSC three months after the fact. Consequently, to be effective, LSC's procedures relating to ensuring adequate financial management by recipients, cannot address each audit report as an isolated event. Rather, LSC's approach should be to consider continuing deficiencies in audit reports as one symptom of the over-all inability for recipients to meet the most fundamental criteria for an adequate accounting and reporting system. The recipient's board of directors and management have the ultimate responsibility to ensure such fundamental criteria are met. The monitoring office and Comptroller's follow-up procedures must be cognizant of this reality. A commitment from the board of directors and program director should be obtained before committing significant LSC resources in an effort to upgrade financial management capabilities. Without such a commitment, the monitoring office directors should pursue other avenues to ensure the integrity and the effective use of LSC funds.</p>	

PROCEDURES AND RESPONSIBILITIES	
AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>3. <u>Follow-up Guidelines: Recipient Financial Management</u></p> <p>Assist and advise the monitoring office as required.</p> <p>a. <u>Ineligible Costs</u></p> <p>Highlight the magnitude of questioned costs in the Desk Audit Documentation Form for disposition by the monitoring office director. Request documentation of the disposition of the questioned costs where the magnitude or nature of the costs warrants such a request.</p> <p>1. Guidelines when cost contravenes a specific LSC guideline</p>	<p>3. <u>Follow-up Guidelines: Recipient Financial Management</u></p> <p>The monitoring office is responsible for follow-up on all situations (essentially those highlighted in the auditor's supplemental letter and the LSC's Desk Audit Documentation Form) which indicates inadequate financial management capabilities. The following are suggested guidelines for addressing specific deficiencies.</p> <p>a. <u>Ineligible Costs</u></p> <p>The monitoring office will generally respond to costs questioned as to eligibility for basically two reasons:</p> <ul style="list-style-type: none"> - The cost contravenes a specific LSC guideline or; - The cost appears unnecessary or unreasonable in the circumstances. <p>The crucial consideration for success in dealing with this area is to demonstrate that LSC can, in fact, control abuses.</p> <p>1. Guidelines when cost contravenes a specific LSC guideline</p> <ul style="list-style-type: none"> - In most cases, there is no legitimate reason for this situation to occur. The requirements are specific, and a waiver, if the situation justifies it, could be obtained from the monitoring office <u>before</u> the expenditure is made. Nevertheless, experience has shown that expenditures which contravene specific guidelines will be made.

PROCEDURES AND RESPONSIBILITIES	
AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>1. Guidelines when cost contravenes a specific LSC guideline (Cont'd)</p> <p>2. Guidelines when costs are judged unnecessary or unreasonable</p>	<p>1. Guidelines when cost contravenes a specific LSC guideline (Cont'd)</p> <ul style="list-style-type: none"> - Contravention of a specific guideline does not lend itself to a standard response since the degree of contravention can vary tremendously. The appropriate response must be determined in each instance by the monitoring office director based upon the seriousness of the contravention. The responses open to the monitoring office director can range from allowing the cost to be charged to LSC's grant, to requiring the recipient's board of directors to address the reasons for the program's inability to comply and resolve them, to requiring reimbursement for the costs from other funds, to initiating defunding proceedings. <p>2. Guidelines when costs are judged unnecessary or unreasonable</p> <ul style="list-style-type: none"> - This question of allowability should be very unusual, based upon the premise that our programs are managed by reasonable people. - If costs are judged to be unnecessary or unreasonable, the board of directors, and the program director could be required to reimburse LSC for these expenditures from other sources. The program director or board of directors should be held accountable where the unreasonableness of the costs is extreme.

PROCEDURES AND RESPONSIBILITIES	
AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>b. Fund Balance Deficits and Excesses</p> <p>Highlight the magnitude of the excess or deficit in the Desk Audit Documentation Form.</p>	<p>b. Fund Balance Deficits and Excesses</p> <p>The monitoring office director should evaluate the question of over or under expenditures with the realization LSC's program are on-going concerns. A short-term minor deficit or excess warrants no action. On the other hand, LSC's only effective response to chronic deficit spending may be a change in the program's management or initiating defunding proceedings. Conversely, a significant fund balance may indicate either a reduction of service to clients or legitimate cost savings that occurred during the year.</p> <p>An adequate response to a significant deficit/surplus situation will be to provide the program director and board of directors with LSC's detailed expectation with regard to future performance, and explain the viable remedies open to LSC should the programs not make progress toward sound fiscal management. LSC should request programs with serious deficits to develop a plan approved by their board of directors, to respond to LSC expectations of future performance. The plan should be adequate to liquidate the deficit and put the program on a solid financial base. It will be the monitoring office director's responsibility to ensure that a poorly managed program does not continue to be a liability to the nationwide legal services effort.</p>

PROCEDURES AND RESPONSIBILITIES	
AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>c. Minor Internal Control Deficiencies</p> <p>Highlight where appropriate in the Desk Audit Documentation Form. Identify recurring minor deficiencies that can be easily corrected, if any.</p>	<p>c. Minor Internal Control Deficiencies</p> <p>This category of deficiencies commonly noted on audit report supplemental letters involves a few minor weaknesses in internal controls and internal procedures. The items to be considered in category are, by their nature not significant deficiencies. A situation such as this should be obvious from the auditor's supplemental letter and the monitoring office director's knowledge of the program. An adequate response in this situation will be to request the program director to correct the deficiencies via a letter or documented phone call. It would require further action only if the same deficiencies were easily correctable but recurred year-after-year. (Refer to Fundamental Criteria.)</p>
<p>d. Major Internal Control Deficiencies</p> <p>One of the Comptroller's Office's priorities is to allocate significant resources to the development and maintenance of adequate accounting and financial reporting in the field programs. The resources can be made</p>	<p>d. Major Internal Control Deficiencies</p> <p>This category of deficiencies includes major weaknesses in internal controls and procedures, and situations where LSC's fundamental criteria are not met in material respects. Examples are situations where</p>

PROCEDURES AND RESPONSIBILITIES	
AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>d. <u>Major Internal Control Deficiencies (Cont'd)</u></p> <p>available to assist the regions when mutual objectives are involved.</p> <p>If deficiencies or problems are major (gross mismanagement or possible defalcations) the Comptroller's Office will allocate whatever resources are necessary to fully respond to and resolve the situation.</p>	<p>d. <u>Major Internal Control Deficiencies (Cont'd)</u></p> <p>double-entry bookkeeping is not utilized, all transactions are not recorded, program has no filing system, disbursements are not supported by vendors' invoices or other support, bank statements are not reconciled, and other blatant deficiencies, or a large number of seemingly minor deficiencies exist, when taken together impeach the creditability of management to adequately manage its resources.</p> <p>This type of situation normally requires a major commitment from recipient's program director and board of directors to change from a laissez-faire attitude to one of attention to financial management and control. The monitoring office director is responsible for precipitating this change.</p>
<p>4. <u>Documentation of Follow-up Procedures</u></p> <p>All follow-up actions in which the Comptroller's Office directly participates will be fully documented in the audit files.</p>	<p>4. <u>Documentation of Follow-up Procedures</u></p> <p>The monitoring office files must contain sufficient documentation to demonstrate that adequate follow-up procedures have been undertaken to dispose of audit recommendations.</p> <p>The monitoring office should provide the Comptroller's Office with copies of correspondence between the monitoring office and recipient or their auditors relating to significant areas. Such documentation will be requested by the Comptroller's Office in cases where the Comptroller's Office requires such documentation to complete the audit files.</p>

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PROCEDURES AND RESPONSIBILITIES	
AUDIT MANAGER	REGIONAL/OTHER OFFICE DIRECTOR
<p>D. <u>Quality Assurance of Field Work</u></p> <p>The Comptroller's Office will perform a quality-assurance review of auditors' work on a systematic basis in accordance with LSC's working paper review program. LSC may preclude the appointment of an auditor based upon unsatisfactory performance or conflict of interest between the recipient and the auditor.</p>	<p>D. <u>Quality Assurance of Field Work</u></p> <p>Regional staff should include procedures in their monitoring visits to review recipient satisfaction with audit arrangements and the professional accounting services received.</p>
<p>E. <u>Requirements of Comptroller General</u></p> <p>As required by Section 1009(c) (2) of the Legal Services Corporation Act amended 1977, LSC must submit a copy of the annual audit of each recipient to the Comptroller General of the United States.</p> <p>By the 10th of each month, LSC's Comptroller's Office will submit a copy of each annual audit received in the previous month to the Comptroller General. A cover letter will be prepared indicating the recipient audits being sent.</p>	<p>E. <u>Requirements of Comptroller General</u></p> <p>N/A</p>

LEGAL SERVICES CORPORATION
Audit Report Delinquency Follow-up Letter

RASOP-I

//

Dear //:

Your audit for the year ended // is currently two months delinquent. The Legal Services Corporation Act as amended 1977, Section 1009(c)(1) states:

"The Corporation shall conduct, or require each grantee, contractor, or person or entity receiving financial assistance under this title to provide for an annual financial audit. The report of each such audit shall be maintained for a period of at least five years at the principal office of the Corporation (LSC)."

In addition to the legal requirement, it is also a prudent management practice to ensure audits of your program are completed on a timely basis. This is one method for the board of directors and the program director to help demonstrate the discharge of their stewardship and fiduciary responsibilities. LSC considers prompt attention to this area as one of the most fundamental requirements for recipients of our funds.

LSC will require your program to be fully current with all audit reporting requirements within forty-five days of the date of this letter. If you find that meeting this requirement is not possible, LSC will assist you to the extent necessary to ensure that the audit requirement will be completed within this time frame.

In order to assist you as expeditiously as possible -- if you are unable to accommodate our requirements; we will arrange a pre-audit meeting with

//
Page Two

auditors of our choice on // at your office. You and your chief fiscal officer must be available to meet with the auditors. Therefore, if it is impossible for you to be present on //, please suggest a timely alternative date. At this meeting, the auditors we select will determine the audit requirements and gather information upon which to develop a schedule for timely completion of the audit and upon which to base their fee estimate. We will arrange for the auditors to bill LSC directly. We will ensure the fees are substantially within the estimates in the contract or job arrangement letter and advise you when they are paid. We will then withhold an amount equal to the audit costs from one of your monthly checks. If the fees substantially exceed the estimates, we would, of course, require the auditors to document all of the reasons for the over-runs to ensure your audit bill is fair, given the circumstances at the program.

Please advise me by // if the meeting date is convenient for you, or if you are able to accommodate our timetable without our assistance.

I hope this assistance will provide the opportunity for the program to get on top of the audit, accounting, and reporting area. Once you are up-to-date with your audit requirements, LSC will expect that you will be able to resume the audit and other fiscal responsibilities for future years.

Sincerely,

Fabio de la Torre
Comptroller

PJY://

cc: Clint Lyons, Director, Office of Field Services
 Patrick J. Yogus, Audit Manager
 // (regional director)
 // (chairman of program board of directors)
 // (auditors)

CONTINUED

2 OF 5

Specific recipient accounting and reporting requirements are discussed in Chapters 2 through 5 of this Guide.

1-8 EFFECTIVE DATE

The effective date of the first edition of the Guide was August 1976. The effective date of the revised Guide is June 1977.

1-9 REVISIONS AND SUPPLEMENTS TO THE GUIDE

Revisions and supplements to this Guide may be made periodically. If this Guide is to provide meaningful instruction, it is imperative that both the recipient and its auditor keep their Guides current. Upon receipt, all revisions/supplements should be incorporated into the recipient's copy of the Guide. It is the responsibility of the recipient to furnish revisions/supplements to its auditor.

1-10 CUMULATIVE STATUS OF REVISIONS AND SUPPLEMENTS

<u>Effective Date</u>	<u>Description</u>
August 1976	First Edition of Guide Issued
June 1977	Revised Edition of Guide Issued
September 1979	Revision to Pages 4-1 and 6-6

(Revised September 1979)

CHAPTER 2 - ACCOUNTING

2-1 ACCOUNTING GUIDELINES

LSC requires that the accounting principles employed by its recipients in recording transactions and preparing financial statements be based upon generally accepted accounting principles (GAAP) for nonprofit organizations. LSC requires that the accounting guidelines discussed in this chapter be used by recipients to effect uniform reporting which will be in substantial compliance with GAAP. For some practices, alternative treatments are currently acceptable; however, the guidelines in this Guide reflect current trends in financial reporting for nonprofit organizations similar to both LSC and its recipients.*

When applying the guidelines of this chapter, every recipient should review the suggested accounting policy in each area in light of its materiality to the program. Items that are not material should be accounted for in the most reasonable and efficient manner. The concept of materiality as used in accounting has been defined as a state of relative importance. The materiality of an item may depend on its size, nature, or a combination of both. The working rule in applying the concept of materiality is to ask the question: "Is the item of sufficient importance to influence the conclusions and actions of users of the financial information?" More specifically, if the items were not accounted for in accordance with the proposed guidelines, would the reader of the financial statements be misled with respect to his understanding of the nature and extent of assets available for use in program operations; the nature and extent of liabilities incurred by the program; the trust relationships that may exist between the program and clients; and, among other considerations, the nature and scope of the program's operations.

* See Bibliography for reference materials used in developing material for this Guide.

Total Financial Picture of the Organization

The purpose of preparing financial statements in accordance with GAAP encompasses more than reporting stewardship of funds. Another important objective is to disclose relevant financial information about an organization so that certain basic conclusions (e.g. magnitude of services being provided or the entity's future viability) can be made by the statements' readers.

LSC provides the majority of the total funding requirements of recipients. The remaining funding is provided by numerous other organizations including the United Way of America; U.S. Department of Health, Education, and Welfare; Law Enforcement Assistance Administration; state and local governments; and private contributors. LSC's perspective is not limited to the segment of the legal assistance that it provides. Its focus is on the effectiveness of the entity as an integrated program in providing legal services to the community. The current trend in the nonprofit industry is to prepare financial statements so that the recipient's board of directors and outside parties can fully comprehend the financial condition of the entire entity. Accordingly, LSC's objective is to obtain financial reports that reflect the recipient's entire operations.

Fund Accounting

One fundamental purpose of the financial statements of a nonprofit organization is to disclose the sources of the organization's resources and how those resources were used, i.e., stewardship reporting. In some instances, a recipient's total support will be provided by LSC; however, for

most recipients there will be additional funding sources. There are normally two categories of support that most recipients will receive.

1. Unrestricted funds - Those resources over which the governing board of directors has discretionary control to use in carrying on the program's operations in accordance with the limitations of its charter and bylaws.
2. Restricted funds - Those resources which bear a legal restriction as to use imposed by parties outside of the organization -- usually by the grantor or contributor.

There may be a few recipients who receive support from an endowment fund. The principal amount of a gift or bequest of an endowment fund must remain intact. Only the income from investing the principal may be used by the entity. Depending upon the terms of the endowment, the income may be spent at the discretion of the board of directors or it may be restricted to a particular use. The provisions of the gift would determine the accounting treatment for the income and principal.

GAAP requires that these different types of resources of the organization be reported separately. Specifically, each recipient should establish an unrestricted fund to be used to record grants, contracts, and contributions which have no restrictions associated with their use and a restricted fund for grants, contracts, and contributions which specify the way these funds may be used.

Most recipients are funded primarily by several major grants and/or contracts. Many grantors require a separate reporting of how their funds were utilized in the recipient's operations. This requirement means that

the books and records must accommodate the accumulating and supporting of costs by grant and contract. To meet this reporting need, the restricted/unrestricted fund, as shown on the financial statements, should be subdivided by the grants or contracts which require separate reporting.

LSC requires separate reporting of its grants or contracts. Most federally funded grants or contracts and possibly some privately funded awards would include the requirement for separate reporting. If the requirement for separate reporting is unclear for certain funds, the recipient should resolve this issue with the appropriate officials from the funding organization. The recipient should attempt to include all funds from funding sources not having the separate reporting requirement in a single restricted or unrestricted fund depending on the circumstances.

Each recipient should evaluate the reporting requirements stipulated by each funding source to insure that proper accounting is followed in the financial statements and accounting records. When grants and contracts are combined, there should be adequate financial statement caption or footnote disclosure of the individual sources and the amounts contributed by each source.

The operating statement (Statement of Support and Expenses and Changes in Fund Balances) must reflect a breakdown of operations in accordance with the criteria specified in this Guide. Separate balance sheet accounts by funds are not required unless, in the opinion of the auditor and management, such disclosure is necessary for a fair presentation of the recipient's balance sheet. However, the fund balance for each fund included in the Statement of Support and Expenses and Changes in Fund Balances must be shown separately on the face of the Balance Sheet.

Special or one-time grants from LSC can be included with the regular grant in the LSC fund, unless the one-time award is specifically designated for the purchase of property and cannot be spent for anything else. In this case, the support should be recognized in its entirety upon the effective date of the grant in the property fund. A recipient's accounting records must be able to support that special grant proceeds were expended in accordance with the grant provisions.

As mentioned above, a property fund should be maintained. The property fund should be used to accumulate the cost or fair market value (if donated) of buildings, furniture, fixtures, equipment, leasehold improvements, and law library; reflect depreciation and amortization thereon; record gains or losses from the disposition of such assets; and record any other transactions specifically relating to fixed assets.

Accrual Basis of Accounting

Recipient's annual financial statements must be prepared on the accrual basis of accounting. Under the accrual basis of accounting, expenses are recorded when incurred as opposed to when they are actually paid. Support is recorded when earned instead of when received.

The requirement is for accrual basis statements, and not for accrual basis record keeping. Many programs find it practical to keep their books on a cash basis throughout the year and, through adjustment at the end of the year, prepare statements on an accrual basis. The requirement is that only the financial statements be presented on the accrual basis and not also that the books be kept on this basis throughout the year.

Property

GAAP requires capitalization and depreciation of property for a fair presentation of the assets and results of operations of a profit or nonprofit entity.

In many cases, funding sources maintain a reversionary interest in property purchased with its funds. Simply stated, a reversionary interest requires that property, or the proceeds from the sale of such property must be returned to the appropriate funding source if at some future date funding of the recipient is terminated. In view of the reversionary interest of certain funding sources, asset accountability is critical. Capitalization of property is an integral part of discharging the stewardship responsibilities over these assets. In addition to allowing the fair presentation of investment in property on the Balance Sheet, capitalization helps insure more effective controls over property and also subjects this account to auditing procedures. Accordingly, capitalization of the cost of property is required by this Guide.

In addition to the capitalization of property, LSC requires the recording of depreciation. Depreciation accounting is a means of distributing the cost or other valuation of an asset (in the case of appraisals or donations) over the asset's estimated useful life in a systematic and rational manner. It is a process of allocation, not valuation. When depreciation is omitted, the cost of providing services is understated. Therefore, depreciation expense should be recognized as an expense of rendering current services and should be included in the Statement of Support and Expenses and Changes in Fund Balances.

The accounting policies for property should also be followed for a recipient's law library (i.e., books, reference materials, and multiple

volume sets of law books) since a law library is as much a long-term asset as the recipient's office equipment. The costs of maintaining a law library should be expensed currently. The judgments as to what constitutes a maintenance item and what constitutes a capital addition must be made after evaluating the nature and significance of the items in question. LSC recommends consultation with the program's auditors with respect to the policy to be adopted. Depreciation should also be computed over the useful life of the library for the difference between the original cost and the salvage value. If the salvage value approximates original cost, depreciation is not necessary.

Each recipient must evaluate the facts and circumstances of its particular library including past history, condition, and marketability of the library to determine a reasonable useful life and salvage value. If the review concludes that it can reasonably be expected that in the event of liquidation the proceeds from the disposition of the library would not differ materially from the original cost, then depreciation expense during the interval would not be necessary.

Although property purchased during a year will not be recognized as expenses for that year, the funds used for the purchase of that property are considered a current-year grant or contract charge. To recognize this characteristic of grant funds, property purchases should be reflected as a reduction in the fund balance of the appropriate funding source. This is accomplished by transferring the cost of property purchased to a separate property fund balance.

In Appendix VII, property and depreciation accounting practices are discussed and illustrated in detail.

Donated Materials, Space, and Property

LSC does not require recipients to match their funding with other contributions or funds; however, there are items that may continue to be donated by individuals or organizations -- supplies, space, furniture, and equipment. In order to ascertain the total cost of providing legal assistance, such items should be recorded and reported in the recipient's financial statements. Donated materials and property should be recorded at their fair market value when received. Fair market value must be determined using the most objective and clearly measurable basis available. The value assigned to donated materials and property, if material, should also be approved by the recipient's board of directors. Extending this concept further, the free use of facilities and other assets should also be recorded as donations with an offsetting charge to the applicable expense.

Donated materials and space should be recorded in the general fund (or a separate fund if required for clarity of presentation) as support and expense in amounts equal to the assigned value of the donations. The amount of donated items included in the general fund must be clearly ascertainable. Donated property and equipment should be recorded as support in the property fund and as an asset in an amount equal to the assigned value. The expense associated with donated property and equipment will be recorded as depreciation over the useful life of the item.

Donated Services

Significant donated services including professional services should be recorded in the same manner as described for donated materials, space, and

property when the following circumstances exist:

1. The services performed are a normal part of the program or supporting services and would otherwise be performed by salaried personnel, in order to accomplish the corporate purpose, if volunteers were not available.
2. The recipient exercises control over the activities and duties of the donors to the extent that control normally would be exercised, considering the professional/clerical status of the donor.
3. The recipient has a clearly measurable basis for the amount to be recorded.

LSC does not want recipients to record donated services which do not realistically contribute to the accomplishment of the corporate purpose. Many recipients, however, receive a significant amount of "free" assistance that if not received would necessitate a reduction in the level of legal services the recipient provides. These include:

1. VISTA volunteers.
2. CETA personnel.
3. Students.
4. Gratis legal research by private attorneys or law school faculty.
5. Professional services provided by local attorneys in lieu of services being provided by legal services attorneys.
6. Pro bono or pro bono publico professional service arrangements.

Every recipient should evaluate the magnitude of services donated to it. If the services are material, a method should be established to value and record them. Normally, the valuation should be at the cost to the recipient if the services had been purchased by the recipient. Adequate

records must be maintained during the year to support the value of donated services recorded, but the actual recording of the services could be done quarterly or at year-end. For professional legal services, two methods are suggested as providing sufficient documentary support -- a predetermined fee schedule or an hourly rate. A major advantage of the fee schedule is that it can be used without having to impose timekeeping requirements on those professionals donating their time to the program. The subject of the adequacy of support for donated services should be discussed with the recipient's auditors. It is usually not necessary to impose detailed record keeping requirements upon donors as long as internal records are adequate and provide an audit trail.

The recognition of significant donated services in the financial statements is critical to a reasonable evaluation of the total cost of legal assistance provided by recipients.

Recognition of Grant and Contract Support

Legal assistance programs receive grants and contracts which can be characterized as either "continuous period" or "cost-reimbursable." While most nonprofit organizations' grants and contracts are cost reimbursable, some grants and contracts such as LSC's provide funding over a prescribed period and normally allow unused funds resulting from efficiencies and cost savings to be utilized during the next period. This arrangement can result in a "fund balance" for the grant; however, there should never be a deficit in an LSC grant. Other type grants and contracts may provide that unused funds cannot be carried over to the next period but must be returned to the grantor.

LSC requires that its continuous period grants or contracts be recognized as support on a pro rata basis over the grant or contract period. For example, if a twelve-month grant period is April-March, and the financial statements are as of December 31, then 75% of the total grant award for that period would be reported as support. Any excess of support over expenses represents, as a general policy, a fund balance to be carried over to the next period or returned to LSC if grant or contract conditions are not complied with or if funding is terminated.

This policy is not applicable to cost-reimbursable grants or contracts. Under this arrangement, the funding source provides funds only as the recipient incurs costs eligible for reimbursement; therefore, support should be recognized only to the extent that eligible costs are incurred during the grant or contract period. In addition, there will never be a fund balance associated with this type of grant or contract since support must always equal eligible costs incurred. Under no circumstances should support be recognized in excess of the award specified in the grant/contract unless approval for additional reimbursement has been received.

For either "continuous period" or "cost-reimbursable" grants and contracts, any difference between support earned and cash received is reflected in the balance sheet as a receivable (i.e., grant support earned exceeds grant cash received), or unearned revenue (i.e., grant cash received exceeds support earned).

The accounting policies associated with grants and contracts must be disclosed in the financial statements.

Contributions

Contributions in the form of cash or cash equivalents (e.g., corporate stocks and bonds, etc.) from private organizations or individuals should be recorded when the cash or equivalent is received. Contributions should be recorded in an unrestricted fund only if they can be used at the discretion of the board of directors for general program purposes. Contributions with restrictions should be recorded in a restricted fund. The provisions written in the grant/contract or other agreement will normally determine the accounting and reporting requirements that must be followed.

Allocation of Expenses Among Funds

It is anticipated that recipients who receive funds from sources other than LSC will incur expenses (e.g., salaries, space, travel) which support work performed under more than one grant, contract, or other funding agreement. Such common costs should be allocated among the funds on the basis agreed to by the applicable funding organizations. In the absence of approved methods, the recipient should develop techniques that will provide a reasonable and measurable basis upon which expenses are allocated.

Some grantors may refuse to pay any overhead costs even though that particular grant is benefited by such costs. In this case, allocation of costs is not necessary because LSC will absorb the overhead costs associated with this grant. Whatever the method used by the recipient, it should be adequately disclosed in the footnotes to the financial statements.

Investments

LSC funds not needed for immediate operating expenses may be invested in Federally insured savings accounts, treasury bills, or certificates of deposit. Recipients may use the interest earned on invested LSC funds provided the use of the proceeds does not increase the annual funding requirements and the proceeds are not used for purposes prohibited by the Act. The investment income should be recorded as revenue in the fund which provides the temporary excess cash available for investment.

Some recipients may have endowment funds or other resources from which management may purchase marketable securities and other investments. In such cases, investments held by recipients may be recorded at either the market value or the lower-of-cost-or-market.*

*

The market-value method requires recognition of unrealized appreciation or depreciation from fluctuations in market prices. Accordingly, under this method of accounting, there are no gains or losses at the time of sale.

Under the lower-of-cost-or-market method, gains on investments are recorded only at the time of sale. However, if the market value falls below the recorded value, and the decline is considered permanent, it will be necessary to reduce the carrying value of the investment to market in the period the decline in value occurs.

The basis of recording investments should be consistent for all investments held by the recipient. There should also be adequate disclosure of the valuation method used in the financial statements.

Employee Benefits

The accounting for employee benefits should normally follow the accrual method of accounting which requires that the expense and liability associated with benefits that have vested with the employee be recorded currently. While this procedure is proper and required for financial statements prepared in accordance with GAAP, the following benefits can be recorded on the cash basis if that method does not materially distort the Statement of Support Expenses and Changes in Fund Balances or the Balance Sheet.

1. Vacation earned by employees, but not taken.
2. Sick leave, termination, or severance pay arrangements which vest.

If the cash basis is selected for material items there must be financial statement disclosure of the liability at the balance sheet date in a footnote and proper disclosure in the auditor's opinion of the divergence from GAAP.

Programs which currently have pension plans are required under the Employee Retirement Income Security Act of 1974 to meet certain standards. In addition, pension expenses must be recorded and reported in accordance with Accounting Principles Board Opinion No. 8.

Programs establishing new pension plans must meet the requirements of the Internal Revenue Service and the Employee Retirement Income Security Act of 1974.

Functional Classification of Expenses

Traditionally, recipients have reported the results of their operations by natural expense classifications (e.g., salaries, travel, space, etc.). However, the current trend in nonprofit accounting, as expressed in

literature applicable to voluntary health and welfare organizations (including the United Way of America's "Accounting & Financial Reporting Manual") is directed toward the functional reporting of expenses. All recent literature has recommended this type of reporting, and a subcommittee of the American Institute of Certified Public Accountants issued, on February 1, 1977, a discussion draft of a "Statement of Position" which, if adopted, will require this presentation in future years. If the recommendations in this document become effective, auditors will not be able to issue an "unqualified" opinion on financial statements which reflect natural expense classifications only.

As a means of assisting recipients in understanding the ramifications of this change, the fundamental concepts of functional expense reporting are discussed herein. Appendix VIII reflects examples of financial statements prepared under the new requirements. The same data presented in Appendix III for Multi-Service Corporation has been presented in Appendix VIII on a functional basis.

The functional classification of operations is divided into the two main categories of expenses incurred by all nonprofit organizations -- "program services" and "supporting services." Program services are defined as the organization's social service activities. Expenses for each separate and identifiable service should be clearly disclosed in the financial statements.

The different services should be described so as to clearly define their purpose, and each classification should include all costs applicable to the services described.

Supporting services should be divided into two subcategories - "fund-raising" and "management/administrative and general." Fund-raising costs

may be defined as those costs incurred in conjunction with the solicitation of money (including costs associated with grant applications), securities, time, materials or facilities for which the contributor will receive no direct economic benefit. Management/administrative and general costs include: salaries and expenses of the chief officers, general record keeping, annual reports, business management, budgeting, general board activities, and all other costs which are not identifiable with any single program or fund-raising activity. Normally a portion of such costs, especially salary costs of chief officers, can be identified with specific program activities. In these cases, an appropriate allocation should be made.

2-2 ACCOUNTING RECORDS

The following is a brief description of the accounting records considered necessary for the adequate recording of financial transactions. Accounting records must be maintained on a double-entry accounting system and must be adequate to enable the recipient to prepare its annual financial statements, internal budget, and other management reports. See Chapter 5 for reporting requirements.

General Ledger - The general ledger is used to summarize and classify all financial transactions from data accumulated in the books of original entry into their proper accounts (i.e., salaries, space, etc.). It is the source for most of the data needed for preparing financial statements. The general ledger is the final and permanent record of all of the recipient's financial transactions.

Cash Receipts Journal - The cash receipts journal is a book of original entry in which cash receipts (i.e., cash, checks, and money orders) are recorded in chronological sequence when received. Bank deposit slips must contain sufficient information so that all deposits can be identified with their source.

Cash Disbursements Journal - A cash disbursements journal is a book of original entry in which disbursements are recorded in a chronological sequence. All disbursements must be made by prenumbered checks used in numerical sequence. Each check must be supported by appropriate documentation (i.e., payroll records, invoices, contracts, travel reports, etc.) evidencing the nature and propriety of the expense, and documenting the approval by an authorized official.

Payroll Records - Basic payroll records must accumulate payroll data required by Federal, state, and local laws. Documentation must be maintained to support individual gross earnings. A personnel file should be established for each employee and should include the following data:

1. Employment contract if applicable, wage or salary authorization.
2. Federal W-4 withholding form.
3. State withholding form.
4. Authorization for all other payroll deductions.
5. Authorization for all wage/salary actions.

Each recipient, in light of its size, is required to establish an adequate time-reporting system. This system must be able to identify employee hours worked so that compliance with Federal and state laws with respect to overtime and pay rates can be demonstrated. It must also be able to demonstrate accountability for time to the public. A small recipient with several employees could use a sign-up sheet whereby every employee would record his/her daily hours. A larger recipient would probably utilize a "time report" system whereby each employee would complete and sign an individual time sheet. Whether a sign-up sheet, a time

report, or other method is utilized, a supervisor in a position to verify the information should approve the document.

A vacation and sick leave record must be maintained currently for each employee. This record would include information in hours or other reasonable units (i.e., days, fractions of days) for the amount of vacations and sick leave earned during the period, taken during the period, and remaining at the end of the period. As a method of checking the accuracy of this record and providing employees with knowledge of "where they stand," each employee should be informed of his vacation and sick leave balance periodically.

Property Records - Individual property records are to be maintained for each item costing in excess of \$100 per unit. Recipients may use a lesser value if a smaller amount is more appropriate for a particular program. For financial statement purposes, all items costing in excess of \$100 must be capitalized and depreciated. The property records to be maintained must include: (1) a description of the item, including model and serial number (if the property has no such number it must be tagged with an identifying number to insure the internal records are effective in controlling property); (2) date of acquisition; (3) number of check used to pay for item; (4) cost; (5) useful life; (6) source of funds used to acquire the property; (7) description of how value was assigned if property was donated; and (8) location of the property. The total dollar value of individual items costing over \$100 must equal the property control account balance in the general ledger.

General Journal/Journal Voucher - A general journal or journal voucher system is used to process transactions which are not recorded originally in the cash receipts journal, cash disbursements journal, or

payroll register. Each journal entry must be supported by a complete explanation and documentation of the transaction being recorded. Journal entries or journal vouchers should be numbered consecutively and approved by an authorized individual.

Client Trust Records - A client trust record must be maintained for each client and used to document and record receipts and disbursements of client funds. The total of the balances of these records must equal: (1) the cash in the escrow bank account designated solely for these funds; and (2) the corresponding client trust liability account. Both accounts are required to be maintained in the general ledger (see Chapter 3 and Appendix VI for discussions of the internal controls associated with this item).

The accounting records discussed in this chapter can be maintained by either a manual or an automated system. Each recipient should establish the system most appropriate to meet its needs and to provide an adequate audit trail of all transactions.

2-3 BASIC CHART OF ACCOUNTS

The following is an illustrative basic chart of accounts which would provide details necessary for the preparation of financial statements in accordance with this Guide. This illustration is not intended to dictate the format or level of detail to be used by individual programs, but is simply one method of achieving the accounting requirements of this Guide. While the account numbering system, account descriptions, and level of detail utilized by recipients should be designed to provide management reporting and financial disclosures specifically related to that program, they must also accommodate the reporting requirements of LSC.

The illustrative chart of accounts assigns a three-digit number to every major natural account classification reflected in the financial statements. By changing the last two digits of the three-digit number, recipients can maintain the greater detail needed to control and monitor operations. For example, the natural account "cash-general" is a broad description. Most organizations would require an individual general ledger account for each bank account. This can be achieved by establishing accounts under a natural account classification as follows:

100 Cash-General

General Disbursement Account - PDQ Bank	101
Payroll Account - PDQ Bank	102
Petty Cash	103
Client Escrow Funds	110

The total of all 100 accounts (i.e., 101, 102, and 103) represents the cash amount reported in the financial statements. Account 110 would be a separate financial statement caption since the use of the cash is restricted. This procedure can be used to maintain details for any of the natural account classifications reported in the financial statements.

By adding prefixes to the natural account classifications, a fund accounting concept can be employed to record support and expenses by different grants and contracts. For example, assume a program has grants from sources other than LSC. Expenses associated with different grants could be accumulated as follows for travel expenses (account number 560):

01.560	Travel - Legal Services Corporation
02.560	Travel - XYZ Grantor
03.560	Travel - ABC Grantor
04.560	Travel - General Fund

By adding suffixes to the natural account classification, a responsibility accounting concept can be employed to record support and expenses by responsibility units (i.e. cost centers). For example, assume a program has three local offices (#s 1, 2 and 3) and a headquarters office (#4). Travel expenses funded by Legal Services Corporation for these cost centers would be accumulated as follows:

01.560.1	Travel - LSC - local office #1
01.560.4	Travel - LSC - headquarters

Travel expenses funded by XYZ for these cost centers would be accumulated similarly:

02.560.1	Travel - XYZ - local office #1
02.560.4	Travel - XYZ - headquarters

A skeleton chart of accounts is shown below. Each program's chart of accounts must reflect the degree of detail appropriate under the circumstances.

<u>Natural Classifications</u>	<u>Account Number</u>
Assets (100 Series)	
Cash - general	100
Client Escrow Funds	110
Receivables	120
Investments	130
Travel advances to employees	140
Prepaid expenses	150
Furniture, fixtures, and equipment	160
Leasehold improvements	170
Law library	180
Accumulated depreciation	190
Liabilities (200 Series):	
Accounts payable	200
Employee withholding payables	210

Accrued expenses	220
Client trust deposits	230
Fund Balance (300 Series):	
Grant/Contract funds	300
General fund	310
Property	320
Support (400 Series):	
Grants and contracts	400
Contributions	410
Donated property and services	420
Interest, dividends, other	430
Expenses (500 and 600 Series):	
Personnel	500
Employee benefits	530
Legal consultants	540
Contract services	550
Travel	560
Space and occupancy	570
Office expenses	580
Litigation costs	590
Equipment rental	600
Miscellaneous purchases of property and library	610
Depreciation and amortization	620
Property Activity (700 Series):	
Acquisition of property	700
Acquisition of library	710
Proceeds from sale of property	720
Gain or loss on sale of property	730

In addition to natural expense classifications by funding source and cost center, recipients should also consider accumulating data by the functional expense classifications of program services and supporting services.

The identification of functional expenses is currently required for certain nonprofit organizations and in the future will probably be required

for all such organizations. In the interim, recipients should begin accumulating this information through memoranda records with footnote disclosures.

2-4 DESCRIPTION OF ACCOUNTS

The basic chart of accounts described in paragraph 2-3 provides one method of organizing a recipient's accounting records. Whether the recipient utilizes this chart of accounts or another, the general ledger must contain the following accounts which record an acceptable level of detail for full financial disclosure. LSC recognizes that recipients may desire a more detailed chart of accounts, especially for expenses. Recipients should develop a chart of accounts which will allow them to effectively report on their financial operations. The following account descriptions are intended to illustrate the nature of the charges that may be made to specific accounts. Particular recipients may require different designations to accommodate their own information needs.

ASSETS

Cash--General Disbursements - To record funds on deposit in bank accounts for operating purposes as opposed to special purposes such as payroll and escrow accounts discussed below. Separate accounts should be maintained for each bank account.

Cash--Payroll Account - To record the amount on deposit in a separate bank account for payment of payroll. Should be maintained on an imprest basis.

Petty Cash - To record cash held at the recipient's office for paying minor bills. The account must be maintained on an imprest basis with the balance established at the lowest possible level commensurate with efficient operations. The petty cash account in the general ledger always reflects the total value of the fund, in cash and/or vouchers. The fund should be reimbursed periodically for the exact amount of the petty cash vouchers.

Cash--Client Escrow Funds - To record cash received from clients as advance payments for court costs. The general ledger balance for this account must equal the liability account "Client Trust Deposits."

Receivable(s) LSC or Other Grantors - To record amounts earned but not received (see grant and contract support paragraph 2-1) under LSC or other grants or contracts. Separate accounts should be maintained for each grant or contract.

Receivable(s)-Other - To record miscellaneous accounts receivable.

Travel Advances to Employees - To record the amount of travel advances outstanding, (i.e., advanced to employees but not accounted for on subsequent expense reports). A subsidiary record or sub-account must be maintained for each employee.

Investments - To record the carrying value of investments in stocks, corporate bonds, certificates of deposit, treasury bills, etc. A subsidiary record should be maintained for each class of investment to account for the cost and income.

Deposits - To record the amount of refundable deposits made, for example, to the telephone company or landlord.

Prepaid Expenses - To record the amount of expenses paid which apply to future periods. LSC recommends that a prepaid expense should not be recorded unless the expense applies to a period more than 18 months from the date incurred and the prepaid balance of an individual item is considered material. The recipient may choose to record additional prepaid items outside this prescribed criteria if management believes the information is needed.

Leasehold Improvements - To record the costs of all items over \$100 incurred in connection with improving rental space (e.g., carpets, new walls, etc.) which cannot be carried to another location.

Furniture, Fixtures, and Equipment - To record the costs of furniture, fixtures, and equipment costing in excess of the capitalizable limit per unit, and having a useful life of over one year.

Law Library - To record the cost of case sets, other reference books, and multiple volume sets of law books. The costs capitalized in this account should reflect only those items which will have a value to the program continuing over more than one year.

Accumulated Depreciation - To record the expiration of the service life of assets; i.e., periodic depreciation expense.

LIABILITIES

Accounts Payable - To record the amount of unpaid vendor invoices on hand. This account should be used at the close of an accounting period to convert the books to the accrual basis of accounting. If books are maintained on the accrual basis, the account will have a continuous balance.

Employee Withholdings Payable - To record the amount of money that has been withheld from the employees' salaries, (i.e., FICA, Federal, state and local taxes, pension, health insurance, etc.). Separate accounts should be maintained for each type of withholding.

Accrued Expenses - To record the estimated cost of goods or services received for which an invoice has not yet been received. The accrual is utilized at the close of an accounting period to record salaries, employer's share of FICA taxes, other taxes etc., which are owed but not paid. Separate accounts should be maintained for accrued salaries and other miscellaneous accruals (e.g., utilities and consultant fees).

Client Trust Deposits - To record the amount of cash received from clients for court costs to be disbursed in the future. The balance must agree with the escrow cash account in the bank.

FUND BALANCE

Restricted - This account accumulates the balance of support over expenses for grants, contracts, and other awards which have restrictions attached. Each grant or contract or other award requiring separate reporting should have a separate account for its fund balance.

Unrestricted - This account accumulates the balance of support over expenses from unrestricted sources. Each contributor or other award requiring separate reporting should have a separate account for its fund balance.

Property - This account accumulates the net equity in all furniture, fixtures, equipment, and law books purchased.

SUPPORT AND REVENUE

Grant and Contracts - To record the amount of funds earned during the accounting period.

Contributions - To record cash and security contributions received during the accounting period.

Donated Property and Services - To record the value (see Section 2-1 for method of valuing donated items) of all significant donated assets, facilities, and services received during the year.

Interest, Dividends, Other Revenue - To record interest earned, dividends earned, and other income earned during the year. This account records miscellaneous income which cannot be classified in any of the above accounts. Where amounts are significant, separate accounts should be established.

EXPENSES

Salaries and Wages - To record the salaries of all program personnel. Normally, including all salaries and wages in one account would not provide adequate information about program activities. The AICPA recommends that salaries and wages be subdivided into those related to program services and those related to supporting services. Each program should subdivide the salaries and wages account into the categories which will be most meaningful for management -- keeping in mind the recommendations of the AICPA to categorize into program and supporting services.

Employee Benefits - To record the costs of items such as employer FICA taxes, unemployment taxes, employer retirement contributions, employer health and life insurance payments, workmen's compensation and other payroll related benefit items offered by the program. Individual subaccounts must be maintained for each of these items.

Legal Consultants - To record the payments for legal consultants who are not full time employees of the program.

Contracted Services - To record the costs of contracted or purchased services. For financial statement purposes contract services should be adequately described as to their nature where material. For example, for proper disclosure, contract services may require classifications into accounting services and other consulting services.

Travel - To record travel costs (e.g., local transportation, lodging expenses while away, and airfare). This account should be subdivided in accordance with the management's needs to control the various elements of travel costs such as travel relating to legal work, travel relating to administrative work, travel related to training, etc.

Space and Occupancy - To record the costs of rent, utilities (such as electricity, water, and gas), janitorial services, and hazard insurance. Individual subaccounts should be maintained for these items as is necessary.

Office Expenses - To record the costs of office supplies, printing, reproduction supplies, advertising and publicity, postage, telephone, and insurance other than hazard and employee benefit insurance. Recipients should establish separate accounts for any of the above items if the amounts are significant.

Litigation Costs - To record costs of depositions and transcripts, service of process, filing fees, expert witnesses, and any other litigation costs paid by the program and not the client.

Equipment Rental - To record all costs of renting or leasing furniture and equipment.

Depreciation of Property - To record the depreciation expenses of furniture, equipment, leasehold improvements, etc. acquired by the recipient.

Library Maintenance - To record the costs of all publications purchased for the library that are not capitalized.

PROPERTY ACTIVITY

Acquisition of Property or Library - To record the costs of all land, furniture, equipment, leasehold improvements and other property or law books costing more than \$100 that were purchased during the year. The account is closed to the applicable fund balance of the source of funds used to purchase the property. This account is the source for the entry to capitalize all property purchases as assets at year end.

Proceeds from Sale of Property - To record the cash received from the sale of property. It is the tie-in for the entry at year end to remove sold property from the books and record the gain or loss on sale.

Note: Adequate financial statement disclosure may require that account descriptions different from the above be used. The above descriptions represent suggestions for grouping similar costs. The level of detail for adequate financial statement reporting and meaningful management reports must be determined by management and the auditor.

CHAPTER 3 - INTERNAL CONTROL

A financial audit will not prevent defalcations and is not intended for that specific purpose. Every program must rely instead upon its own system of internal accounting controls and procedures to promptly detect and help reduce the likelihood of misappropriation of funds. The objectives of internal controls are not limited to this purpose only. This chapter discusses minimum internal control procedures recipients must establish to meet the objectives inherent in the definition of internal control.

3-1 DEFINITION

Internal controls encompass the coordinated methods and measures adopted by an organization to safeguard assets, check the accuracy and reliability of accounting data, promote operating efficiency, and encourage adherence to prescribed management policies.

Obviously this is a broad definition and extends beyond those matters which relate directly to accounting and financial reporting. It encompasses controls over all of the paper work in an organization.

This chapter will emphasize the physical and administrative controls over a program's assets -- principally cash. At best the required and suggested procedures will minimize the likelihood of misappropriation of assets and misstatement of accounts and maximize the likelihood of detection if it occurs.

3-2 CHARACTERISTICS

In establishing an adequate system of internal control, certain basic concepts must be considered. Although each organization is unique, and, therefore, any control procedures must likewise be unique and "custom made," the following characteristics are generally applicable.

1. Definition of authority and responsibility. The duties of all program personnel should be defined as to their specific responsibilities. Such a delineation may be flexible and informal in a small program with few employees, or it may be carefully defined by an administrative manual in a larger program. In the accounting area this means that only certain specified individuals may sign checks, approve invoices for payment, prepare grant and contract reports, and deposit cash receipts.
2. Segregation of duties. Broadly considered, segregation of duties means that program and accounting functions should be separated so that no individual simultaneously has both the physical control and the recordkeeping responsibility for any asset (e.g., cash, client deposits, supplies and property). Within the accounting area, duties preferably should be segregated so that no individual can initiate, execute, and record a transaction without a second individual being involved in that process. If this level of segregation is not possible because of the program's size, the work of the accountant should be reviewed and approved by the program director or his delegate.
3. Establishment of independent checks and proofs. Independent checks and proofs consist of regular internal checks on the recording of transactions and the preparation of financial reports. For example, a certain measure of clerical accuracy can be accomplished through the use of a columnar cash disbursements journal that is balanced monthly and posted to the general ledger. Thereafter, the general

ledger cash balance would be reconciled to the monthly bank statement. Another control procedure is illustrated when a subledger of client deposits is maintained, compared monthly to the general ledger account balance for client trust funds, and the accuracy of this subledger is reviewed periodically by an employee outside the accounting department familiar with legal cases and deposits received.

3-3 PRIMARY FEATURES

The following features are considered basic internal control procedures that any program, regardless of size, should establish. It can not be overemphasized that these features represent only the rudimentary control procedures that must be incorporated by every recipient to demonstrate a minimum level of financial stewardship. Once these features have been successfully implemented, recipients should begin assessing additional procedures to provide greater control assurances. A complete checklist of potential internal control procedures that should be evaluated for program applicability is presented in Appendix VI.

1. Each recipient should have adequately trained competent accounting personnel to properly document, record, account for, and report on its financial transactions.
2. All bank accounts must be authorized by the recipient's board of directors. There must be sufficient justification for utilizing more than one bank account. Any account not used must be closed and the bank notified in writing not to process any subsequent transactions. Any remaining blank checks for closed accounts must be destroyed.
3. All cash receipts must be recorded in a journal. Checks received must be restrictively endorsed, and deposited intact currently.
4. Prenumbered receipts must be issued for all money received from clients. Accountability in the form of duplicate copy of the receipts issued must be maintained.
5. All disbursements (other than petty cash disbursements) must be made by prenumbered checks signed by an individual(s)

- authorized by the board of directors. No checks may be made payable to cash.
6. All disbursements must be supported by vendors' invoices or other supporting documents.
 7. Bank statements must be reconciled monthly to the general ledger balance. The reconciliations must be reviewed and approved by a responsible individual and retained.
 8. A separate bank account must be maintained only for client funds. The controls over this account should be as complete as the controls established for the program's regular bank account.
 9. Each program must establish a method to determine the balance for each client's trust fund. The total of the individual client funds held should be reconciled to the general ledger bank account and liability balance, and to the bank reconciliation on a monthly basis.
 10. Petty cash funds must be maintained on an imprest basis and recorded in the general ledger.
 11. The physical facilities for storing investment certificates, blank checks, general ledger, subsidiary ledgers and other important documents must be adequate.
 12. Detailed property records must be maintained and reconciled to the general ledger. Once a year an inventory must be taken of the program's property and the results of that inventory compared to the accounting records. Significant differences should be investigated.
 13. There should be fidelity insurance on all individuals who handle cash, sign checks, have purchasing or other financial responsibilities.
 14. There must be an organized filing system for all paid invoices, canceled checks, contracts and agreements, reports to funding sources, tax returns (with supporting work papers), and employee files.
 15. There must be interim management reports preferably prepared monthly, but at least quarterly, that compare actual expenditures to budget. The program director should review the reasons for any significant variations from the budget, and also compare projected future expenditures against the unexpended portion of the budget.

CHAPTER 4 - INELIGIBLE COSTS4-1 CRITERIA

This chapter establishes criteria for determining the eligibility of costs incurred under LSC grants or contracts. The general concept of eligibility is that all costs incurred by the recipient must be necessary and reasonable for the effective operation of the program. Reasonable costs are defined as costs which reflect the actions of a prudent person after considering the circumstances and conditions at the time the costs were incurred.

4-2 INELIGIBLE COSTS

LSC has identified the following costs which are ineligible charges to LSC grants or contracts:

1. Costs not adequately supported by vendors' invoices, payroll registers or other documents.
2. Costs that are unreasonable or unnecessary.
3. Costs of the following, (to exclude audit contracts which are exempt), incurred without the prior written approval of the regional director.
 - a. Consultant contracts in excess of \$2,500.
 - b. Consultant fees in excess of \$182 per day/\$22.75 per hour.
 - c. Purchases of equipment having a single item or cumulative cost in excess of \$5,000.
 - d. Leases of equipment when the single item or cumulative purchase price would exceed \$5,000.
4. Costs specifically excluded by the grant or contract agreement or LSC rules, regulations, or guidelines.

(Revised September 1979)

CHAPTER 5
FINANCIAL STATEMENTS AND REPORTS

This chapter discusses the annual and interim report requirements of recipients and illustrates the statement formats to be used.

5-1 REQUIREMENTS FOR QUARTERLY FINANCIAL REPORTS

The regional director will determine the reporting requirements which are appropriate for his region. All such reporting requirements will be communicated to the recipients by the regional director. The Comptroller's Office requires no quarterly reports.

5-2 REQUIREMENTS AND FORMAT
OF ANNUAL FINANCIAL REPORTS

Each recipient is required to submit three copies of its annual financial statements (i.e., audit report and auditors' supplemental letter) to the Audit Manager in the Comptroller's Office, Legal Services Corporation, Washington, D.C., and one copy to the appropriate regional director within 90 days of its year-end. The transmittal letter to the region should indicate that the appropriate copies have been sent to the Comptroller's Office. The transmittal letter to the Comptroller's Office should indicate that a copy has been forwarded to the region.

The responsibility for preparing the annual financial statements is divided between the recipient and the auditor.

Responsibility of Recipient

- a. Comparative Balance Sheet.
- b. Comparative Statement of Support and Expenses and Changes in Fund Balances.
- c. Notes to financial statements disclosing principles of accounting, commitments, and other matters not obvious from the statements themselves and deemed necessary for fair presentation or required under generally accepted accounting principles.
- d. Transmittal of the annual financial statements and supplemental letter to LSC within the 90 day time frame.

Responsibility of auditor

- a. Auditor's report on the financial statements.
- b. Auditor's supplementary letter.

The following is the suggested format for the financial statements. Illustrative financial statements using the accounting principles discussed in this Guide are shown in Appendices I, II and III. A sample auditor's supplemental letter is shown in Appendix IV.

5-3. RECOMMENDED BALANCE SHEET FORMAT

(NAME OF RECIPIENT)

BALANCE SHEET
AS OF DECEMBER 31, 197X AND 197Y

<u>A S S E T S</u>				<u>LIABILITIES AND FUND BALANCES</u>	
	<u>197X</u>	<u>197Y</u>		<u>197X</u>	<u>197Y</u>
CURRENT ASSETS:			LIABILITIES:		
Cash	\$	\$	Accounts payable	\$	\$
Client escrow funds			Employee withholdings payable		
Receivables -			Accrued expenses		
Legal Services Corporation			Client trust deposits		
HEW					
Smith Foundation			Total liabilities	-----	-----
Investments (Note 1)				-----	-----
Prepaid expenses					
Total current assets	-----	-----			
PROPERTY:			COMMITMENTS AND CONTINGENCIES (Note 4)		
Furniture, fixtures, and equipment					
(net of accumulated depreciation of			FUND BALANCES:		
\$XXXX in 197X and \$XXXX in 197Y)			Restricted -		
(Note 1)			Legal Services Corporation		
Total property	-----	-----	HEW		
Law library			Miscellaneous grants		
			Unrestricted		
Total assets	-----	-----	Property		
	\$	\$	Total fund balances	-----	-----
	-----	-----	Total	-----	-----
	\$	\$		-----	-----
	-----	-----		\$	\$
	-----	-----		-----	-----

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The accompanying notes are an integral part of this statement.

NOTE: This balance sheet is illustrative in nature and may not reflect adequate disclosure for every legal services program. The appropriate disclosure required by generally accepted accounting principles must be made for each program individually.

5-4. RECOMMENDED STATEMENT OF SUPPORT,
EXPENSES, AND CHANGES IN FUND
BALANCE FORMAT

(NAME OF RECIPIENT)

STATEMENT OF SUPPORT AND EXPENSES AND CHANGES IN FUND BALANCES
FOR THE YEAR ENDING DECEMBER 31, 197X, WITH COMPARATIVE TOTALS FOR 197Y

	197X						197Y
	Legal Services Corporation Grant	HEW Grant	Smith Foundation	Miscellaneous Grants	Unrestricted	Property and Equipment	
SUPPORT:							
Grants and contracts	\$	\$	\$	\$	\$	\$	\$
Donated property and services							
EXPENSES:							
Personnel -							
Lawyers							
Non-lawyers							
Employee benefits							
Legal consultants							
Contract services							
Travel							
Space and occupancy							
Office expenses							
Equipment rental							
Depreciation							
Litigation costs							
SUPPORT OVER (UNDER) EXPENSES							
FUND BALANCE, beginning of year							
OTHER CHANGES IN FUNDS:							
Acquisition of property							
Transfer of proceeds from sale of property							
FUND BALANCE, end of year	\$	\$	\$	\$	\$	\$	\$

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The accompanying notes are an integral part of this statement.

NOTE: This statement is illustrative in nature and may not reflect adequate disclosure for every legal services program. The appropriate disclosure required by generally accepted accounting principles must be made for each program individually.

5-5 SUGGESTED FOOTNOTE CONTENT(NAME OF RECIPIENT)NOTES TO FINANCIAL STATEMENTSFOR THE YEARS ENDED DECEMBER 31, 197X and 197Y

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(Footnote should include explanations of all the significant accounting policies used by the recipient. See specific policies outlined in Section 2-1 of this Guide. Examples of the types of items to be included are: purpose and legal form of entity, recognition of support, capitalization of fixed assets, depreciation methods and useful lives, allocation of costs among funding sources, investment valuation, policies on donated items and services, and vacation policy.)

(2) SUMMARY OF FUNDING

(Footnote should include a description of each material support source, any restrictions on use of funds or assets, total amount of funds available from executed grants/contracts, periods of funding covered by such grants/contracts, and a summary of expected funds to be received in the future. If the number of sources is large this information can be shown in a supplemental schedule.)

(3) EMPLOYEE BENEFITS

(Footnote should include a description of any pension plan or material benefits to employees and should be presented in accordance with generally accepted accounting principles. A statement should be made as to whether the plans are qualified as nontaxable by the Internal Revenue Service.)

(4) COMMITMENTS AND CONTINGENCIES

(Footnote should include but not be limited to a description of any lawsuits or claims which could result in a material liability or any potential loss; description of any material contract or lease commitments which the recipient has entered into; and other commitments or contingencies of the recipient which should be disclosed in order to insure the financial statements are not misleading.)

(5) INCOME TAXES

(Footnote should include but not be limited to a description of Federal and state tax status of the recipient including private foundation status.)

(6) MANAGEMENT/ADMINISTRATIVE AND GENERAL, AND FUND-RAISING

(Footnote should include an estimate of the management/administrative and general, and fund-raising expenses incurred during the period. Recipients should begin gearing up to meet the functional reporting requirement. Based upon the latest proposed position of the AICPA, functional reporting will be a requirement for future audit reports.)

(7) PREVIOUS YEAR'S FINANCIAL INFORMATION

The comparative financial statement format recommended in this Guide reflects totals only for the previous year's operations. Since comparative financial statements are considered necessary by LSC, the following comment should be included in a footnote: "The amounts shown for (prior year) in the accompanying Statement of Support and Expenses and Changes in Fund Balances are included to provide a basis for comparison and present summarized totals only. Accordingly, the (prior year) amounts are not intended to present all information necessary for fair presentation in accordance with generally accepted accounting principles."

(8) NONRECURRING ITEMS

(Footnote should disclose any material item of support or expense which would not normally be expected to recur in the foreseeable future.)

(9) RELATED PARTY TRANSACTIONS

(Footnote should disclose all financial transactions of the recipient with related parties such as directors and officers.)

* * * * *

Note:

These footnotes are merely examples of probable items which should be part of the financial statements and are not to be considered all inclusive and/or required in all circumstances. The appropriate disclosure determination must be made for each program individually.

CHAPTER 6 - AUDITS

6-1 AUDIT REQUIREMENTS

Congress has granted LSC authority to require annual financial examinations of recipients of LSC financial assistance. Specifically, Section 1009(c)(1) of the Act states:

"The Corporation shall conduct or require each grantee, contractor, person or entity receiving financial assistance under this title to provide for an annual financial audit. The report of each such audit shall be maintained for a period of at least five years at the principal office of the Corporation."

Financial statements must be prepared substantially in accordance with generally accepted accounting principles as prescribed by this Guide. In an effort to obtain substantial uniformity of reporting among recipients, LSC has reviewed current accounting practices and included in Section 2-1 of this Guide certain accounting principles for recipients to follow. The recommended principles substantially reflect current trends in accounting principles for nonprofit organizations. The auditor should review this Guide for familiarity with the recommended principles and the specific reporting requirements prescribed by LSC.

6-2 AUDIT STANDARDS

The selection of an auditor, together with contracting for auditing services, is the responsibility of the recipient (see Section 6-13 for a sample contract). Recipients are not required to obtain approval from LSC before engaging an auditing firm. LSC does, however, reserve the right to preclude the appointment of an auditor if experience has shown the auditor's work to be unsatisfactory or if a conflict of interest exists between the recipient and the auditor.

6-3 AUDIT OBJECTIVES

The objectives of the examination are to determine whether:

1. The financial statements fairly present the recipient's financial position and results of operations in accordance with generally accepted accounting principles applied on a consistent basis with the preceding period.
2. The accounting system and related internal controls of the recipient are operating effectively and adequate records are being maintained.
3. Costs incurred are reasonable, applicable to the legal assistance program, and eligible under LSC requirements.

6-4 SCOPE OF AUDITS

The scope of each audit will be established in accordance with generally accepted auditing standards and will include an examination of the financial statements and tests of transactions sufficient to enable the auditor to express an opinion on the financial statements. While the audit scope must be designed to meet this objective, it must also include sufficient tests to insure that (a) costs are eligible under the LSC's criteria discussed in Chapter 4 of this Guide, and (b) the recipient is in compliance with the accounting terms and conditions of the contract or grant. It is not intended, however, that the auditor should increase the scope of his work for these items above the scope necessary to issue an unqualified opinion on the financial statements -- unless significant exceptions are encountered.

If an auditor has a question about any item in this Guide, it should be directed to the attention of the Audit Manager in the LSC Comptroller's Office, Washington, D.C.

6-5 AUDITOR'S REPORT

The primary objective of the auditor's examination is the expression of an opinion on the recipient's financial statements. Specifically, the auditor's opinion must cover the following financial statements:

1. Comparative Balance Sheet.
2. Comparative Statement of Support and Expenses and Changes in Fund Balances.
3. Related footnotes to the financial statements.

In addition to rendering his opinion on the financial statements, the auditor is required to issue a supplemental letter. The supplemental letter must be submitted separately from the financial statements. This letter is the vehicle through which the auditor should advise LSC and the recipient's board of directors of his observations and recommendations. The letter is intended for use by management, the board of directors, and LSC, and would not normally have a wider distribution. The auditor must comment in the supplemental letter on the following specific items to the extent they are observed within the scope of his examination.

1. Suggestions for improvements in the recipient's internal control procedures.
2. The status of the prior year's internal control comments.
3. Significant and unusual transactions occurring during the year.
4. Compliance with the financial and accounting conditions of the grant or contract.
5. Whether the costs incurred during the period are eligible to be charged to LSC funds.

The supplemental letter must contain a summary of costs considered ineligible under LSC's criteria for such costs as described in Chapter 4.

6-6 AUDITOR'S OPINION

It is expected that an unqualified opinion will be issued by the auditor. If, however, it is believed that an unqualified opinion cannot be issued, the auditor must notify the Audit Manager in the LSC Comptroller's Office in Washington, D.C., of the circumstances precipitating a qualified opinion as soon as these circumstances come to the auditor's attention.

6-7 COMMENTS - INTERNAL CONTROL CHECKLIST

The second standard of field work expressed in Statement on Auditing Standards No. 1 (SAS 1) is as follows:

"There is to be a proper study and evaluation of the existing internal control as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted."

The requirements of this Guide are not intended to increase the auditor's study and evaluation of internal control procedures beyond that contemplated by Section 320 of SAS 1.

The internal control checklist included in Appendix VI is presented for the auditor to utilize in his review as he deems appropriate. The checklist is intended to be a guide. It is not intended to alter the scope of the review or to supplant the auditor's judgment. No questionnaire or checklist can relieve the auditor of the responsibility for possessing a complete understanding of the requirements of adequate internal control procedures. The checklist has been worded so that affirmative answers indicate that the recipient's controls are adequate. It is also recognized that not all questions may be applicable to a particular recipient.

6-8 FINANCIAL AND ACCOUNTING COMPLIANCE CHECKLIST

The following checklist was prepared to assist the auditor in reviewing the recipient's compliance with the financial and accounting conditions of its LSC grant or contract. Items of noncompliance noted in this checklist must be discussed with recipient's management and included in the auditor's supplemental letter.

I. GENERAL

- A. Has the recipient satisfactorily corrected all prior noncompliance comments with respect to:

- (1) Internal control improvements.
 - (2) Financial and accounting compliance with the grant or contract agreement.
 - (3) Questions on eligibility of costs.
- B. Is the recipient exempt from Federal income taxes under Section 501(c)(3) of the Internal Revenue Code of 1954? Further, has the recipient applied for and received a determination that it is not a "private foundation" under Section 509(a) of the Internal Revenue Code?
- C. Has the applicable state income tax exemption been obtained?
- D. Has the recipient received exemption from sales and use taxes, occupational tax, etc. where available?
- E. For recipients who have elected to withhold and pay FICA taxes, was a certificate (Form SS-15) waiving exemption from FICA taxes filed with the Internal Revenue Service?*
- F. Where the audit is not being performed on the entire operations of the recipient, has LSC approved a limited examination?
- G. If the program had proceeds from the sale of assets during the year in excess of \$500, was the sale of these assets approved by the LSC regional director?
- II. INELIGIBLE COSTS
- A. Has the recipient incurred costs not adequately supported by vendors' invoices, payroll registers, or other documents?
- B. Are there costs that are unreasonable or unnecessary? (These costs are by nature a matter of judgment. When reported by the auditor, they should be accompanied by an adequate explanation of the nature and circumstances surrounding the expenditure and comments by the applicable program officials. See Chapter 4 for definitions of reasonable costs.)
- C. Have any of the following items been incurred without the prior written approval of the regional director? (Audit services are specifically excluded from the category of consultant contracts and fees).

* If the waiver was never filed but the recipient erroneously reported wages for its employees and paid the related contributions due, the recipient may now be required to provide coverage for its employees under provisions of the "Ottinger" Bill, P.L. 94-563.

- (1) Consultant contracts in excess of \$2,500.
- (2) Consultant fees in excess of \$182 per day/\$22.75 per hour.
- (3) Purchases of equipment having a single item or cumulative cost in excess of \$5,000.
- (4) Leases of equipment when the single item or cumulative purchase price would exceed \$5,000.

D. Were any costs incurred which were specifically excluded by the grant or contract agreement, or which were not in compliance with the terms thereof?

III. TRAVEL

Are travel expenses incurred in compliance with the recipient's procedures?

IV. INTERNAL CONTROL

Has the recipient implemented and followed accounting procedures adequate in the circumstances, as summarized in Chapter 3 - INTERNAL CONTROL, Appendix VI, ACCOUNTING PROCEDURES AND INTERNAL CONTROL CHECKLIST, and LSC's Fundamental Criteria of an Accounting and Financial Reporting System for LSC Recipients?

(Revised September 1979)

6-9 RECOMMENDED FORMAT - AUDITOR'S SUPPLEMENTAL LETTER

(NAME OF RECIPIENT)

RECIPIENT NUMBER XXXXXX

AUDITOR'S COMMENTS FOR

THE YEAR ENDED DECEMBER 31, 19XX

(Date of Report)

To the Board of Directors

(Name of Recipient):

We have examined the financial statements of (NAME OF RECIPIENT) for the year ended December 31, 19XX, and have issued our report thereon dated (date of audit report). As a part of our examination, we reviewed and tested the Recipient's system of internal accounting control to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards. Under these standards the purpose of such evaluation is to establish a basis for reliance thereon in determining the nature, timing, and extent of other auditing procedures that are necessary for expressing an opinion on the financial statements.

The objective of internal accounting control is to provide reasonable, but not absolute, assurance as to the safeguarding of assets against loss from unauthorized use or disposition, and the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a system of internal accounting control should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management.

There are inherent limitations that should be recognized in considering the potential effectiveness of any system of internal accounting control. In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes of judgment, carelessness, or other personal factors. Control procedures whose

effectiveness depends upon segregation of duties can be circumvented by collusion. Similarly, control procedures can be circumvented intentionally by management with respect either to the execution and recording of transactions or with respect to the estimates and judgments required in the preparation of financial statements. Further, projection of any evaluation of internal accounting control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions and that the degree of compliance with the procedures may deteriorate.

Our study and evaluation of the Recipient's system of internal accounting control for the year ended December 31, 19XX, which was made for the purpose set forth in the first paragraph above, would not necessarily disclose all weaknesses in the system. However, during such study and evaluation certain matters came to our attention. All of the matters discussed herein were considered during our examination of the financial statements as of December 31, 19XX, and do not modify our opinion. These matters will be considered by us in connection with subsequent examinations. Our study and evaluation, which included the areas specified in the Legal Services Corporation's "Audit and Accounting Guide for Recipients and Auditors" issued in August 1976 and revised in June 1977, disclosed the following matters that we would like to call to your attention.

1. Suggestions for improving internal control procedures:
 - a.
 - b.
 - c.
2. Significant and unusual transactions noted during the accounting period:

- a.
- b.
- c.
- 3. The recipient is in compliance with the financial and accounting conditions of the grant/contract except as follows:
 - a.
 - b.
 - c.
- 4. Cost incurred under the LSC grant/contract were tested by us in accordance with generally accepted auditing standards to the extent such costs came within the scope of our work necessary to issue an opinion on the financial statements. As a result of the examination, \$_____ of costs have been listed on Exhibit I for a determination by LSC as to whether such costs are in accordance with the criteria of Chapter 4 of the Guide or with the terms of the LSC grant/contract.
- 5. The recipient has corrected the prior year's comments except as follows:
 - a.
 - b.
 - c.

This letter of comments is furnished solely for the information of management and Legal Services Corporation and is not to be used for any other purpose.

Very truly yours,

Enclosure

6-10 DOCUMENTS TO BE FURNISHED THE AUDITOR

Before commencing the examination, the auditor should arrange for the recipient to furnish the following materials, as required, to allow him to perform the audit more efficiently.

- 1. Copies of all grants and contracts (including any modifications, attachments, amendments, and all general and special provisions).
- 2. A copy of the prior year's audit report and auditor's supplemental letter (if other auditors were engaged).
- 3. A copy of all pertinent grant and contract instructions, handbooks, and other directives.
- 4. Copies of all correspondence affecting financial considerations of the recipient's grants and contracts.
- 5. Copies of all financial reports submitted to the LSC regional office during the accounting period in accordance with the recipient's grants and contracts.
- 6. Copies of all other contractual agreements.
- 7. A copy of the recipient's Federal income tax, state income tax, sales, or other tax exemption certificates (if any).
- 8. A copy of the minutes of the board of directors, and if applicable, executive committee meetings during the accounting period.
- 9. A copy of the recipient's articles of incorporation, bylaws and any amendments thereto.
- 10. An explanation of allocation procedures used to allocate costs among funding sources.
- 11. A copy of the Legal Services Corporation Act and any extensions, amendments, etc.
- 12. Copies of any audit reports for other funding sources.
- 13. A copy of the prior year's Federal tax return (Form 990).
- 14. Documentation for donated services, such as CETA, received during the year.

6-11 CONFIRMATION TO LSC

As part of the audit procedures, each auditor should confirm the financial details of the LSC grant/contract with the Comptroller's Office of LSC in Washington, D.C. The following sample confirmation letter will be satisfactory for these purposes. The content of the confirmation letter should, of course, be adjusted to reflect any specific requirements the auditor may have.

Comptroller
Legal Services Corporation
733 15th Street, N.W. Suite 700
Washington, D.C. 20005

Dear Sir:

Our auditors (insert name of firm) are now engaged in an examination of our financial statements. In connection therewith, they desire to confirm the information as contained on the attached schedule * relating to our grant(s)/contract(s) with you during the period to . Please confirm the amount, effective date, and number of months for each component of action(s) , , and so that our auditors may verify our recognition of support for the period.

Our auditors also desire to confirm the following payments during the period to :

	<u>Check Date</u>	<u>Check Amount</u>	<u>Related Action Number</u>
1.	_____	_____	_____
2.	_____	_____	_____
3.	_____	_____	_____
4.	_____	_____	_____
5.	_____	_____	_____
6.	_____	_____	_____
7.	_____	_____	_____
8.	_____	_____	_____
9.	_____	_____	_____
10.	_____	_____	_____
11.	_____	_____	_____
12.	_____	_____	_____
Total		\$ _____	

Please indicate in the space provided below whether the information herein is in agreement with your records. After signing and dating your reply, please return it directly to (firm name and address). A stamped, addressed envelope is enclosed for your convenience.

Sincerely,

Program Director

To _____ (Firm) Re: _____ (Name of Recipient)

The information relating to the grant/ contract award action and payments during the period is in agreement with our records with the following exceptions (if any).

Date: _____

Signed: _____

Title: _____

* Confirmation of LSC grant(s)/contract(s) can most easily be achieved by enclosing copies of the "Explanation of Legal Services Corporation Grant/Contract Award", which is attached to and is part of the approved award.

6-12 FORMAL ARRANGEMENT FOR AUDITOR'S SERVICES

It is necessary to have a clear understanding between the recipient and the auditor about (1) what the auditor is engaged to do, and (2) the extent of his responsibility in what he is engaged to do. Any lack of agreement between the parties as to either the scope of the work or the extent of the auditor's responsibilities is a potential source of trouble.

An understanding of the work to be performed and the extent of the auditor's responsibilities can be accomplished through either a formal contract or an arrangement letter submitted by the auditor to the recipient. An example of an acceptable contract that contains most items that should normally be included in the auditor/recipient understanding is presented on the following pages.

6-13 SAMPLE AUDITOR'S CONTRACT

This Agreement is entered into on the ____ day of ____, 19__, by the (Full name of recipient) (hereinafter called the "Program"), and (Full name of Accountant or Accounting firm) Independent Public Accountant (hereinafter called the "Contractor").

WHEREAS the Program desires the Contractor to conduct and perform an examination of the financial statements of the Program as of _____ and for the year ending _____.

NOW, THEREFORE, the Program and the Contractor do mutually agree as follows:

1. The Contractor shall examine the financial statements of the Program for the year ending _____, 19__, in accordance with generally accepted auditing standards and the auditing and reporting provisions of the "Audit and Accounting Guide for Recipients and Auditors" dated August 1976 revised June 1977 by Legal Services Corporation. The audit performed shall be sufficient in scope to enable the Contractor to express an opinion in the audit report on the financial statements. Auditing procedures will include, among other things, tests of documentary evidence supporting the transactions recorded in the accounts as well as review of the system of internal control and the accounting procedures as a basis for determining the scope of the Contractor's work. This work will be based primarily upon selected sampling and tests of the accounting records. While certain types of defalcations and similar irregularities may occasionally be disclosed by examinations of this type, they are not designed for that purpose and will not afford assurance that defalcations, etc., will be uncovered. However, if any irregularities come to the attention of the Contractor, they will be promptly reported to the program's director, the program's board of directors, and Legal Services Corporation's Audit Manager.

2. The Program agrees to provide assistance to the Contractor such that the audit report shall be submitted within 90 days after the fiscal year-end -- _____, 19__.

3. The Contractor will also be responsible for the preparation of the program's Federal information return (Form 990). The Contractor does not have responsibility for any other tax returns.

4. The Program agrees to pay the Contractor as compensation for the services mentioned herein a fee computed according to the Contractor's normal hourly rates. It is estimated that the fee for the year ended _____, 19__, will not exceed \$ _____ unless approved in advance of actual incurrence by the program's director.

5. The Contractor certifies that its principal officers, owners or members are independent Certified Public Accountants and/or independent Licensed Public Accountants licensed on or before December 31, 1970, who are certified or licensed by a regulatory authority of a state or other political subdivision of the United States.

6. The Contractor shall not discriminate against any employee or applicant for employment because of race, color, religion, sex, age, or national origin. The Contractor shall take affirmative action to insure that applicants are employed, and employees are treated during employment, without regard to race, color, religion, sex, age, or national origin. Such action shall include, but not be limited to, the following: employment, upgrading, demotion, or transfer; recruitment or recruitment advertising; layoff or termination; rates of pay or other forms of compensation; and selection for training, including apprenticeship. The Contractor will, in all solicitations or advertisements for employees placed by or on behalf of the Contractor, state that all qualified applicants will receive consideration for employment without regard to race, color, religion, sex, or national origin.

7. It is understood that the funds for this contract are supplied by the Legal Services Corporation which is entitled to all reports and relevant information furnished the program's management and Board of Directors.

8. For a period of five years, the Contractor shall make its work papers, records, and other evidence of the audit available to the Legal Services Corporation, and (Program's Name).

IN WITNESS WHEREOF, the Program and the Contractor have executed this Agreement the day and year first above written.

(Program)

By _____

(Name of Independent Public Accountant)

By _____

6-14 EXIT CONFERENCE

Upon completion of the field work, the auditor must hold a closing or "exit" conference with senior officials of the recipient to discuss the audit report and the comments to be included in the supplemental letter. The officials in attendance should include, at least, an official designated by the board of directors, the program director and a senior financial officer such as the controller or chief accountant.

It is expected that all points included in the supplemental letter should be available for review at the exit conference. The exit conference provides the auditor with a final opportunity to obtain additional information which may have a bearing on his conclusions, and also with the mechanism to personally discuss the recipient's financial and accounting status with top management and the board of directors. A draft of the supplemental letter should be available for review at the exit conference.

ABC LEGAL SERVICES, INC.
CLEARWATER, OHIO

FINANCIAL STATEMENTS FOR THE YEAR ENDED
DECEMBER 31, 197X
WITH COMPARATIVE TOTALS FOR 197Y
TOGETHER WITH AUDITOR'S REPORT

ILLUSTRATIVE SMALL RECIPIENT
FUNDED ENTIRELY BY LEGAL SERVICES CORPORATION

BILL JONES, CPA
133 Grant Street
Clearwater, Ohio 44853
(614) 468-9535

March 10, 197Z

To the Board of Directors of
ABC Legal Services, Inc.

I have examined the balance sheet of ABC LEGAL SERVICES, INC., as of December 31, 197X and December 31, 197Y, and the related statement of support and expenses and changes in fund balances for the year ended December 31, 197X. My examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as I considered necessary in the circumstances.

In my opinion, the accompanying financial statements present fairly the financial position of ABC Legal Services, Inc., as of December 31, 197X and December 31, 197Y, and the results of its operations and changes in fund balances for the year ended December 31, 197X, in conformity with generally accepted accounting principles consistently applied during the periods.

Bill Jones
CPA

ABC LEGAL SERVICES, INC.

BALANCE SHEET

AS OF DECEMBER 31

<u>A S S E T S</u>		<u>LIABILITIES AND FUND BALANCES</u>			
	<u>197X</u>	<u>197Y</u>	<u>197X</u>	<u>197Y</u>	
CURRENT ASSETS:			LIABILITIES (all current):		
Cash	\$3,000	\$2,800	Accounts payable	\$ 350	\$ 300
Client escrow funds	400	200	Accrued expenses	1,500	2,000
Receivable - Legal Services Corporation	2,500	2,000	Employee withholding payable	250	500
	-----	-----	Client trust deposits	400	200
Total current assets	5,900	5,000	Total liabilities	2,500	3,000
	-----	-----		-----	-----
PROPERTY (Note 1):			COMMITMENTS (Notes 1 and 3)		
Furniture, fixtures, equipment (net of accumulated depreciation of \$1,000 in 197X and \$500 in 197Y)	2,200	1,100	FUND BALANCES (Note 1):		
Law library	500	500	Restricted -		
	-----	-----	Legal Services Corporation	3,400	2,000
Total property	2,700	1,600	Property	2,700	1,500
	-----	-----	Total fund balances	6,100	3,500
Total assets	\$8,600	\$6,600	Total liabilities and fund balances	\$8,600	\$6,600
	-----	-----		-----	-----

The accompanying notes are an integral part of this balance sheet.

ABC LEGAL SERVICES, INC.

STATEMENT OF SUPPORT AND EXPENSES AND CHANGES IN FUND BALANCE
FOR THE YEAR ENDED DECEMBER 31, 197X, WITH COMPARATIVE TOTALS FOR 197Y

	197X			197Y (Note 5)	
	Legal Services Corporation (Restricted)	Unrestricted	Property		Total
SUPPORT:					
Grant (Notes 1 and 2)	\$100,000	\$ -	\$ -	\$100,000	\$75,000
Donated property and services (Note 1)	-	4,400	600	5,000	4,000
	100,000	4,400	600	105,000	79,000
EXPENSES:					
Salaries and wages					
Lawyers (Note 1)	65,000	4,400	-	69,400	51,000
Non-lawyers	10,000	-	-	10,000	10,000
Employee benefits	5,000	-	-	5,000	3,000
	80,000	4,400	-	84,400	64,000
Legal consultants	3,000	-	-	3,000	3,000
Contract services	3,500	-	-	3,500	2,000
Travel	3,300	-	-	3,300	2,500
Space and occupancy	3,500	-	-	3,500	2,000
Office expenses	1,000	-	-	1,000	1,400
Equipment rentals	1,300	-	-	1,300	1,100
Depreciation	-	-	500	500	400
Litigation costs	2,000	-	-	2,000	1,000
	97,600	4,400	500	102,500	77,400
SUPPORT OVER EXPENSES	2,400	-	100	2,500	1,600
FUND BALANCE, beginning of year	2,000	-	1,600	3,600	2,000
OTHER CHANGES IN FUND BALANCES:					
Acquisition of property	(1,000)	-	1,000	-	-
FUND BALANCE, end of year	\$ 3,400	\$ -	\$2,700	\$ 6,100	\$ 3,600

The accompanying notes are an integral part of this statement.

ABC LEGAL SERVICES, INC.NOTES TO FINANCIAL STATEMENTSFOR THE YEARS ENDED DECEMBER 31, 197X AND 197Y

(I) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Operations -

ABC Legal Services, Inc. ("ABC") is a nonprofit corporation organized for the purpose of providing legal assistance in noncriminal proceedings or matters to persons financially unable to afford legal assistance in Clearwater, Ohio and surrounding area. ABC is primarily funded through grants from Legal Services Corporation ("LSC"), a nonprofit corporation established by Congress to administer a national legal assistance program.

(b) Grant Support -

ABC recognizes grant funds from LSC as support on a straight-line basis over the grant period. Funds remaining unexpended at the end of an accounting period are recorded in the LSC fund balance. In accordance with a general LSC policy, ABC may use unspent funds in future periods as long as expenses incurred are in compliance with the specified terms of the LSC grant, as defined. LSC may, at its discretion, request reimbursement for expenses or return of unexpended funds, or both, as a result of noncompliance by ABC with the terms of the grant. In addition, if ABC terminates its LSC grant activities, all unexpended funds are to be returned to LSC.

(c) Furniture, Fixtures, and Equipment -

Property and equipment acquired with LSC funds are considered to be owned by ABC while used in the program or in future authorized programs. However, LSC retains a reversionary interest in these assets as well as the right to determine the use of any proceeds from the sale of such assets.

ABC follows the practice of capitalizing all expenditures for property and equipment in excess of \$100. Depreciation of property and equipment is computed on a straight-line basis over the estimated service lives of the assets. The estimated service life of furniture, fixtures, and equipment is ten years.

(d) Law Library -

ABC capitalizes the costs of books, reference materials, and multiple volume sets of law books. ABC estimates the salvage value of its law library approximates the original cost and, accordingly, depreciation expense is not recorded. LSC retains a reversionary interest in the law library.

(e) Donated Property and Services -

Property donated to ABC is recorded at its market value at the time of receipt. Donated property valued at \$600 is included in the accompanying financial statements for 197X.

Donated services valued at \$4,400 were received from three local attorneys working on a special case and are included in the general fund of the accompanying financial statements as a part of personnel costs of lawyers. These services were valued at the rates normally charged for similar services.

Donated property and services are recognized both as support and expenses, and therefore, do not affect ABC's fund balances.

(f) Accrued Vacation -

Accumulated earned vacation amounting to \$950 at December 31, 197X, is not recorded in the accompanying financial statements. If accumulated vacation had been recorded at the end of the prior year, the current charge to expense to adjust the accrual to reflect the liability for vacations at December 31, 197X would not have been material.

(2) SUMMARY OF FUNDING

ABC's grants with LSC provided funding of \$100,000 and \$75,000 for the grant periods calendar 197X and 197Y, respectively. ABC has been awarded a \$125,000 grant by LSC for calendar 197Z. The LSC Funds are restricted, to be used only for purposes authorized under the Legal Services Corporations Act of 1974.

(3) COMMITMENTS

ABC has entered into a lease agreement for the rental of office space. Under the lease agreement, ABC is required to make annual lease payments of \$2,000 through January 1, 19XX.

(4) INCOME TAXES

ABC is exempt from Federal income taxes under Section 510(c)(3) of the Internal Revenue Service Code and from Ohio income taxes. In addition, ABC has been determined by the Internal Revenue Service not to be a "private foundation" within the meaning of Section 509(a) of the code.

(5) 197Y FINANCIAL INFORMATION

The amounts shown for 197Y in the accompanying Statement of Support and Expenses and Changes in Fund Balances are included to provide a basis for comparison with 197X and present summarized totals only. Accordingly, the 197Y amounts are not intended to present all information necessary for a fair presentation in accordance with generally accepted accounting principles.

(6) MANAGEMENT/ADMINISTRATIVE AND GENERAL, AND FUND-RAISING COSTS

ABC estimates its management/administrative and general costs (which include overall direction, accounting, budgeting, general board activities and related items) were approximately \$25,000 in 197X and \$18,000 in 197Y. In addition, ABC has determined that fund-raising costs are not material.

Note: These footnotes and those reflected in Appendices II and III are illustrative in nature and should be read in that context. No LSC policies are established herein. The appropriate disclosure required by generally accepted accounting principles must be made for each program individually.

Appendix II

ECONOMIC LEGAL AID CORPORATION
RICHMOND, VIRGINIA

FINANCIAL STATEMENTS FOR THE YEAR ENDED
DECEMBER 31, 197X
WITH COMPARATIVE TOTALS FOR 197Y
TOGETHER WITH AUDITOR'S REPORT

ILLUSTRATIVE MEDIUM-SIZED RECIPIENT
FUNDED BY LEGAL SERVICES CORPORATION AND OTHERS

STEWART, BROWN & COMPANY
1200 Elm Street
Richmond, Virginia 22133
(703) 785-9325

March 15, 197Z

To the Board of Directors of
Economic Legal Aid Corporation:

We have examined the balance sheet of ECONOMIC LEGAL AID CORPORATION, as of December 31, 197X and December 31, 197Y, and the related statement of support, revenue and expenses and changes in fund balances for the year ended December 31, 197X. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying financial statements present fairly the financial position of Economic Legal Aid Corporation as of December 31, 197X and December 31, 197Y, and the results of its operations and changes in fund balances for the year ended December 31, 197X, in conformity with generally accepted accounting principles consistently applied during the periods.

STEWART, BROWN & COMPANY

ECONOMIC LEGAL AID CORPORATION

BALANCE SHEET

AS OF DECEMBER 31

<u>A S S E T S</u>			<u>LIABILITIES AND FUND BALANCES</u>			
	<u>197X</u>	<u>197Y</u>		<u>197X</u>	<u>197Y</u>	
CURRENT ASSETS:			LIABILITIES (all current):			
Cash	\$ 92,600	\$ 8,550	Accounts payable	\$ 10,518	\$ 6,000	
Client escrow funds	1,300	1,200	Accrued expenses	16,750	17,800	
Receivables -			Employee withholding payables	5,800	5,750	
Legal Services Corporation	-	22,000	Client trust deposits	1,300	1,200	
ACE Foundation	16,518	17,000	Unearned support	55,550	-	
	-----	-----		-----	-----	
Total current assets	\$110,418	48,750	Total liabilities	89,918	30,750	
	-----	-----		-----	-----	
			COMMITMENTS AND CONTINGENCIES (Note 4)			
PROPERTY (Note 1):			FUND BALANCES (Note 1):			
Furniture, fixtures, and			Restricted -			
equipment (net of accumulated			Legal Services Corporation	13,500	8,000	
depreciation of \$13,500 in			Unrestricted	7,000	10,000	
197X and \$6,000 in 197Y)	29,000	27,500	Property	32,000	30,000	
Low library	3,000	2,500		-----	-----	
	-----	-----	Total fund balances	52,500	48,000	
Total property	32,000	30,000		-----	-----	
	-----	-----	Total liabilities and	\$142,418	\$78,750	
Total assets	\$142,418	\$78,750	fund balances	\$142,418	\$78,750	
	-----	-----		-----	-----	

The accompanying notes are an integral part of this balance sheet.

ECONOMIC LEGAL AID CORPORATION

STATEMENT OF SUPPORT, REVENUE AND EXPENSES AND CHANGES IN FUND BALANCES
FOR THE YEAR ENDED DECEMBER 31, 197X, WITH COMPARATIVE TOTALS FOR 197Y

	197X					197Y (Note 6)
	Restricted		Unrestricted	Prorated	Total	
	Legal Services Corporation	ACE Foundation Grant				
SUPPORT AND REVENUE:						
Grants and contracts (Notes 1 and 2)	\$600,000	\$198,237	\$ -	\$ -	\$798,237	\$814,200
Contributions (Note 1)	-	-	45,000	-	45,000	35,200
Donated services	-	-	20,000	-	20,000	10,000
Gain on sale of equipment	-	-	-	1,000	1,000	-
	600,000	198,237	65,000	1,000	864,237	924,000
EXPENSES (Note 1):						
Salaries and wages -						
Lawyers	330,000	110,000	15,000	-	455,000	445,000
Non-lawyers	30,000	10,000	30,000	-	70,000	65,000
Employee benefits	26,000	9,500	2,500	-	38,000	35,000
	386,000	129,500	47,500	-	563,000	545,000
Legal consultants (Note 8)	50,000	-	-	-	50,000	50,000
Contract services	12,000	-	-	-	12,000	12,000
Travel	27,000	5,237	5,000	-	37,237	37,237
Space and occupancy	79,000	40,000	10,000	-	129,000	125,000
Office expenses	27,000	14,500	5,000	-	46,500	23,000
Equipment rental	6,500	6,000	-	-	12,500	11,500
Depreciation	-	-	-	7,500	7,500	5,000
Litigation costs	1,000	500	500	-	2,000	1,500
	588,500	195,737	68,000	7,500	859,737	866,000
SUPPORT AND REVENUE OVER (UNDER) EXPENSES	11,500	2,500	(3,000)	(6,500)	4,500	58,000
FUND BALANCE, beginning of year	8,000	-	10,000	30,000	48,000	(10,000)
OTHER CHANGES IN FUNDS:						
Acquisition of property	(5,000)	(2,500)	(2,000)	9,500	-	-
Transfer of proceeds from sale of equipment	-	-	2,000	(2,000)	-	-
FUND BALANCE, end of year	\$ 14,500	\$ -	\$ 7,000	\$ 31,000	\$ 52,500	\$ 48,000

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The accompanying notes are an integral part of this statement.

ECONOMIC LEGAL AID CORPORATION
NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 197X AND 197Y

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Operations -

Economic Legal Aid Corporation ("ELAC") is a nonprofit corporation organized for the purpose of providing legal assistance in noncriminal proceedings or matters to persons financially unable to afford legal assistance in the Richmond, Virginia, and surrounding area. ELAC is principally funded through grants from Legal Services Corporation ("LSC"), a nonprofit corporation established by Congress to administer a nationwide legal assistance program.

(b) Grant Support -

ELAC recognizes grant funds from LSC as support on a straight-line basis over the grant period. Funds remaining unexpended at the end of an accounting period are recorded in the LSC fund balance. In accordance with normal LSC policies, ELAC may use unspent funds in future periods as long as expenses incurred are in compliance with the specified terms of the LSC grant, as defined. LSC may, at its discretion, request reimbursement for expenses or return of funds, or both, as a result of noncompliance by ELAC with the terms of the grant. In addition, if ELAC terminates its LSC grant activities, all unexpended funds are to be returned to LSC. ELAC recognizes funds as support from the ACE Foundation's ("ACE") cost-reimbursable grant when eligible costs are incurred. A receivable is recognized to the extent grant support earned exceeds cash advances. Conversely, a liability (unearned support) is recorded when grant or contract cash advances exceed support earned.

(c) Contributions -

Contributions represent cash donations to ELAC from private organizations and individuals and are recognized as support when received.

(d) Furniture, Fixtures, and Equipment -

Property and equipment acquired with LSC and ACE funds are considered to be owned by ELAC while used in the program or in future authorized programs. However, both funding sources have a reversionary interest in these assets. LSC has the right to determine the use of any proceeds from the sale of assets purchased with its funds.

ELAC follows the practice of capitalizing all expenditures for property and equipment in excess of \$100. Depreciation of furniture, fixtures, and equipment is computed on a straight-line basis over the estimated service lives of the assets. Estimated useful lives of 5 years have been assigned to furniture, fixtures, and equipment.

(e) Law Library -

ELAC capitalizes the costs of books, reference materials, and multiple volume sets of law books. ELAC estimates the salvage value of its law library approximates the original cost and, accordingly, depreciation expense is not recorded. A reversionary interest in the law library is retained by ELAC's funding sources.

(f) Donated Services

Donated services valued at \$15,000 were received from three local attorneys working on a special case and are included in the general fund of the accompanying financial statements as a part of personnel costs of lawyers. Donated services valued at \$5,000 were received from law students assigned to work with staff attorneys and are included in the general fund as a part of personnel costs of non-lawyers. Donated services are valued at rates equal to those paid ELAC staff performing similar work. These services are recognized both as support and expenses, and therefore do not effect the general fund balance.

(g) Allocation of Expenses -

In some cases, common expenses are incurred which support the work performed under more than one grant. Such expenses are allocated between LSC and ACE as agreed by these funding organizations or, in the absence of an agreement, on the basis which appears most reasonable to ELAC. A portion of the space costs shown in the accompanying financial statements was allocated 75% to LSC and 25% to ACE, a basis approved by the funding sources. Portions of office expenses, equipment rental, and litigation costs were allocated 66-2/3% to LSC and 33-1/3% to ACE, approximately in the ratio of costs authorized by each funding organization.

(h) Accrued Vacation -

Accumulated earned vacation amounting to \$1,000 at December 31, 197X, is not recorded in the accompanying financial statements. If accumulated vacation had been recorded at the end of the prior year, the current charge to expenses to adjust the accrual to reflect the liability for vacations at December 31, 197X, would not have been material.

(2) SUMMARY OF FUNDING

ELAC's operations are funded through grants from LSC and ACE. During 197Y, ELAC received a six-month grant for \$368,000 from the Department of Health, Education, and Welfare (HEW) to provide legal assistance in Charlottesville, Virginia. This program was subsequently included in the LSC funding to ELAC when the HEW grant expired. The following details ELAC's 197X grants and contracts and their inclusion in the accompanying financial statements.

Grant Numbers	Period	Amount	197X Support	Unrecognized Support
LSC 300100-7X-1	4/01/XX - 3/31/7X	\$ 400,000	\$ 100,000	\$
LSC 300109-7X-1	4/01/7X - 3/31/7X	667,000	500,000	167,000
		<u>\$ 1,067,000</u>	<u>\$ 600,000</u>	<u>\$ 167,000</u>
ACE 105	1/01/XX - 12/31/7X	1,083,000	198,237	1,000
		<u>\$ 2,150,000</u>	<u>\$ 798,237</u>	<u>\$ 168,000</u>

ELAC has been awarded an additional grant from LSC and a grant from ACE for the year ending December 31, 197Z, of \$240,000 and \$250,000, respectively. The LSC grant has been awarded for the nine-month period April 1, 197Z, to December 31, 197Z. The ACE grant has been awarded for the 12-month period ending December 31, 197Z. Both Grants are restricted -- to be used only for purposes authorized under the Legal Services Corporation Act of 1974. Both LSC and ACE Foundation require separate reporting of support and expenses and changes in fund balances applicable to their funding.

(3) ANNUITY PENSION PLAN

Included in employee benefit costs are \$11,000 in 197X and \$9,500 in 197Y, which represent the cost of a noncontributory annuity plan to provide employees with retirement benefits. Under the plan, ELAC contributes an amount equal to 4 1/2% of the salaries of employees with more than three months of continuous service. There are no past service costs associated with the plan, and employees are fully vested for all contributions on their behalf after two years.

(4) COMMITMENTS AND CONTINGENCIES

ELAC has entered into a lease agreement for the rental of office space. Under the lease agreement, ELAC is required to make annual lease payments of \$53,000 through October 31, 19XX. Such lease payments are adjustable every two years due to the property tax escalation clause included in the lease. In addition, ELAC has leased certain office equipment which requires annual payments of \$5,000 through 19XX.

(5) INCOME TAXES

ELAC is exempt from Federal income taxes under Section 501(c)(3) of the Internal Revenue Service Code and from Virginia income taxes. In addition, ELAC has been determined by the Internal Revenue Service not to be a "private foundation" within the meaning of Section 509(a) of the code.

(6) 197Y FINANCIAL INFORMATION

The amounts shown for 197Y in the accompanying Statement of Support and Expenses and Changes in Fund Balances are included to provide a basis for comparison with 197X and present summarized totals only. Accordingly, the 197Y amounts are not intended to present all information necessary for a fair presentation in accordance with generally accepted accounting principles.

(7) MANAGEMENT/ADMINISTRATIVE AND GENERAL, AND FUND-RAISING COSTS

ELAC estimates its management/administrative and general costs (which include overall direction, accounting, budgeting, general Board activities and related items) were approximately \$93,000 in 197X and \$89,500 in 197Y. In addition, ELAC has determined that fund-raising costs are not material.

(8) NONRECURRING ITEM

In 197X, ELAC incurred \$40,000 of expenses for the research and development and installation of a new automated statistical information system. It is not expected that this expense will recur in the foreseeable future.

(9) TRANSACTION WITH A RELATED PARTY

ELAC's office space in Richmond, Virginia, is rented from the chairman of ELAC's Board of Directors. Management believes the rental payment (currently \$18,000 a year) is less than the rent that would be paid to a nonaffiliated party.

Note: These footnotes and those reflected in Appendices I and III are illustrative in nature and should be read in that context. No LSC policies are established herein. The appropriate disclosure required by generally accepted accounting principles must be made for each program individually.

MULTI-SERVICE CORPORATION

WASHINGTON, D.C.

FINANCIAL STATEMENTS FOR THE YEAR ENDED

DECEMBER 31, 197X

WITH COMPARATIVE TOTALS FOR 197Y

TOGETHER WITH AUDITOR'S REPORT

ILLUSTRATIVE LARGE RECIPIENT

FUNDED BY LEGAL SERVICES CORPORATION AND MULTIPLE

OTHER FUNDING SOURCES

MANN, BARR, MURRAY & CO.
1656 Iowa Street
Washington, D.C. 20006
(202) 725-3865

March 20, 1972

To the Board of Directors of
Multi-Service Corporation:

We have examined the balance sheet of MULTI-SERVICE CORPORATION, as of December 31, 197X and December 31, 197Y, and the related statements of support, revenue and expenses and changes in fund balances for the year ended December 31, 197X. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying financial statements present fairly the financial position of Multi-Service Corporation as of December 31, 197X and December 31, 197Y, and the results of its operations and changes in fund balances for the year ended December 31, 197X, in conformity with generally accepted accounting principles consistently applied during the periods.

MANN, BARR, MURRAY & CO.

MULTI-SERVICE CORPORATION

BALANCE SHEET

AS OF DECEMBER 31

<u>A S S E T S</u>		<u>197X</u>	<u>197Y</u>	<u>LIABILITIES AND FUND BALANCES</u>		
CURRENT ASSETS:				LIABILITIES (all current):		
Cash					<u>197X</u>	<u>197Y</u>
Certificates of deposit, 5%	\$ 20,400	\$ 22,000		Accounts payable	\$ 58,400	\$ 57,500
Client escrow funds	132,000	115,000		Accrued expenses	57,800	51,300
Receivables -	8,500	10,300		Employee withholding payables	4,500	1,300
Legal Services Corporation	40,400	45,900		Client trust deposits	8,500	10,300
HEW	16,000	10,200		Total liabilities	<u>129,200</u>	<u>120,400</u>
Brown Foundation	12,300	11,500				
Travel advances to employees	8,500	5,000		COMMITMENTS AND CONTINGENCIES		
Prepaid expenses	7,300	3,200		(Note 4):		
Total assets	<u>245,400</u>	<u>223,100</u>		FUND BALANCES:		
PROPERTY (Note 1):				Restricted -		
Furniture, fixtures, equipment (net				Legal Services Corporation	9,400	49,400
of accumulated depreciation of				Brown Foundation	40,000	2,000
\$234,500 in 197X and \$210,600	272,200	181,100		Unrestricted	66,800	51,300
in 197Y)				Property	362,200	266,100
Law library (net of accumulated	90,000	85,000		Total fund balances	<u>478,400</u>	<u>368,800</u>
depreciation of \$35,000 in 197X	362,200	266,100		Total liabilities and		
and \$22,000 in 197Y)				fund balances		
Total property	<u>362,200</u>	<u>266,100</u>			<u>\$607,600</u>	<u>\$489,200</u>
Total assets	<u>\$607,600</u>	<u>\$489,200</u>			*****	*****

The accompanying notes are an integral part of this balance sheet.

MULTI-SERVICE CORPORATION

STATEMENT OF SUPPORT, REVENUE AND EXPENSES AND CHANGES IN FUND BALANCES
FOR THE YEAR ENDED DECEMBER 31, 197X, WITH COMPARATIVE TOTALS FOR 197Y

	197X						197Y (Note 6)	
	Restricted				Unrestricted	Property		Total
	Legal Services Corporation	HEW Grant	Brown Foundation	Miscellaneous Grants				
SUPPORT AND REVENUE:								
Grants and contracts (Notes 1 and 2)	\$1,250,000	\$881,000	\$400,000	\$100,000	-	\$-	\$2,631,000	
Contributions (Note 1)	-	-	-	-	\$220,000	-	220,000	
Interest	16,000	-	4,000	-	2,000	-	22,000	
Donated property and services (Note 1)	-	-	-	-	18,000	17,000	35,000	
Gain on sale of equipment	-	-	-	-	-	14,000	14,000	
	<u>1,266,000</u>	<u>881,000</u>	<u>404,000</u>	<u>100,000</u>	<u>240,000</u>	<u>31,000</u>	<u>2,922,000</u>	
EXPENSES (Note 1):								
Salaries and wages -								
Lawyers	829,000	444,000	200,000	61,000	90,000	-	1,624,000	
Non-lawyers	60,000	50,000	21,000	5,000	40,000	-	176,000	
Employee benefits	99,000	53,000	23,000	6,000	11,500	-	192,500	
Legal consultants	987,000	547,000	244,000	72,000	141,500	-	1,991,500	
Contract services	38,000	100,000	16,000	4,000	20,000	-	178,000	
Travel	30,000	82,500	7,000	2,000	8,200	-	129,700	
Space and occupancy	29,000	20,500	14,400	4,000	9,600	-	77,500	
Office expenses	106,000	45,000	39,000	10,000	20,000	-	220,000	
Equipment rental	31,500	22,000	13,600	3,000	15,400	-	85,500	
Depreciation	34,000	26,000	11,000	3,000	7,800	-	81,800	
Litigation costs	7,500	6,000	1,000	2,000	4,000	23,900	34,400	
	<u>1,263,000</u>	<u>849,000</u>	<u>390,000</u>	<u>100,000</u>	<u>226,500</u>	<u>23,900</u>	<u>2,812,400</u>	
EXCESS SUPPORT AND REVENUE OVER EXPENSES	<u>3,000</u>	<u>32,000</u>	<u>54,000</u>	<u>-</u>	<u>13,500</u>	<u>7,100</u>	<u>83,500</u>	
FUND BALANCE, beginning of year	49,400	-	2,000	-	51,300	266,100	368,800	
OTHER CHANGES IN FUND BALANCE:								
Acquisition of property	(43,000)	(32,000)	(16,000)	-	(18,000)	109,000	-	
Transfer of proceeds from sale of equipment	-	-	-	-	20,000	(20,000)	-	
FUND BALANCE, end of year	<u>\$ 9,400</u>	<u>\$ -</u>	<u>\$ 40,000</u>	<u>\$ -</u>	<u>\$ 66,800</u>	<u>\$362,200</u>	<u>\$ 478,400</u>	

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The accompanying notes are an integral part of this statement.

MULTI-SERVICE CORPORATIONNOTES TO FINANCIAL STATEMENTSFOR THE YEARS ENDED DECEMBER 31, 197X AND 197Y

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Operations -

Multi-Service Corporation ("MSC") is a nonprofit corporation organized for the purpose of providing legal assistance in noncriminal proceedings or matters to persons financially unable to afford legal assistance in the metropolitan Washington, D.C. area.

Legal Services Corporation ("LSC"), a nonprofit corporation organized by Congress to administer a nationwide legal assistance program, and the Brown Foundation provide continued support to MSC through annual grants.

(b) Grant and Contract Support -

MSC recognizes grant/contract funds from LSC and the Brown Foundation as support on a straight-line basis over the grant/contract period. Funds remaining unused at the end of an accounting period are carried in the applicable fund balance. In accordance with the normal policies of LSC and the Brown Foundation, MSC may retain unexpended funds for use in future periods provided expenses incurred are in compliance with the specified terms of each grant/contract, as defined. LSC and the Brown Foundation may, at their discretion, request reimbursement for expenses or return of funds, or both, as a result of noncompliance by MSC with the terms of the grants/contracts. In addition, if MSC terminates its legal assistance activities, all unexpended funds are to be returned to the funding sources.

MSC recognizes contract funds from the Department of Health, Education, and Welfare ("HEW") as support when eligible costs are incurred. A receivable is recognized to the extent contract support earned exceeds cash advances. Conversely, a liability (unearned support) is recorded when contract cash advances exceed support earned.

(c) Contributions -

Contributions represent cash donations to the program from private organizations and individuals and are recognized as support when received.

(d) Furniture, Fixtures, and Equipment -

Property and equipment acquired with LSC, Brown Foundation, and HEW funds are considered to be owned by MSC while used in the program or in future authorized programs. However, the funding sources have a reversionary interest in the property as well as the right to determine the use of any proceeds from the sale of assets purchased with their respective funds.

MSC follows the practice of capitalizing all expenditures for property and equipment in excess of \$100. Depreciation of all property and equipment is computed on a straight-line basis over the estimated service lives of the assets. Amortization of leasehold improvements is computed on a straight-line basis over the terms of the lease since that period is shorter than the estimated service life. The following lives have been assigned to the capitalized assets.

Building	50 years
Improvements to land and buildings	10 to 50 years
Furniture, fixtures, and equipment	5 years

(e) Law Library -

MSC capitalizes the costs of library books and multiple volume sets of law books. MSC estimates the salvage value of its law library at approximately half of the original cost. Depreciation is computed on the straight-line basis over the estimated service life which management believes approximates 15 years.

(f) Donated Property and Services -

Property donated to MSC is recorded at its market value at the time of receipt. Donated property valued at \$17,000 is included in the accompanying financial statements for 197X.

Donated services valued at \$18,000 represent services rendered by various attorneys in the Washington, D.C. area at no charge to MSC in connection with MSC's legal assistance program. The value of donated services is based upon an estimated average fee normally charged by the professionals rendering the services.

Donated property and services are recognized both as support and expenses and therefore, do not affect MSC's fund balances.

(g) Allocation of Expenses -

In some cases, common expenses are incurred which support the work performed under more than one grant or contract. Such expenses are allocated among LSC, HEW, and the Brown Foundation as agreed by these funding sources or, in the absence of an agreement, on the basis which appears most reasonable to MSC. Space costs shown in the accompanying financial statements were allocated 46% to LSC, 23% to HEW, 23% to Brown Foundation, and 8% to the general fund, a basis which has been approved by the funding sources. Portions of office expenses and equipment rental have been allocated 50% to LSC, 25% to HEW, 15% to the Brown Foundation, and 10% to the general fund, approximately in the ratio of number of employees authorized by each funding source.

(2) SUMMARY OF FUNDING

MSC is funded primarily through a grant from LSC, a contract with Brown Foundation, and a cost-reimbursable contract from the U.S. Department of Health, Education, and Welfare. The HEW contract expired on December 31, 197X, and was not extended. MSC's grant from LSC and its contract with Brown Foundation continue through June 30, 197Z, and March 31, 197Z, respectively. At December 31, 197X, MSC had remaining funds of \$750,000 for the LSC grant and \$125,000 for the Brown Foundation contract. The following information summarizes MSC's major grant and contract activity during 197X.

<u>Number</u>	<u>Period</u>	<u>Amount</u>	<u>197X Support</u>	<u>Unrecognized Support</u>
<u>LSC</u>				
100500 7Y-1	7/1/7Y- 6/30/7X	\$1,000,000	\$ 500,000	\$ -
100500 7X-1	7/1/7X- 6/30/7Z	<u>1,500,000</u>	<u>750,000</u>	<u>750,000</u>
		2,500,000	1,250,000	750,000
<u>HEW</u>				
10132	1/1/7Y- 12/31/7Z	1,900,000	881,000	3,000
<u>Brown Foundation</u>				
7501	6/30/7Y- 3/31/7Z	<u>875,000</u>	<u>400,000</u>	<u>125,000</u>
		<u>\$5,275,000</u>	<u>\$2,531,000</u>	<u>\$ 878,000</u>

In addition to its primary grant and contracts, MSC received and recorded the following as "Miscellaneous grants and contracts" in the accompanying financial statements.

	<u>197X Support</u>
United Way	25,000
City of Washington	50,000
Smith Foundation	15,000
Jones Foundation	10,000
	<u>\$100,000</u>

All funds are restricted to be used only for purposes authorized under the Legal Services Corporation Act of 1974. Legal Services Corporation, HEW, and Brown Foundation require a separate reporting of support and expenses and changes in fund balances applicable to their funds.

(3) PENSION PLAN

MSC has a noncontributory pension and disability plan for all full-time employees. MSC's policy is to fund normal costs and amortize past services costs on a current basis. Expenses of the plan in the accompanying financial statements were \$51,300 for 197X and \$47,200 for 197Y. As of December 31, 197X, the plan's net assets aggregated \$230,000 and the actuarially computed value of vested benefits were \$143,000. Unfunded past services costs of \$93,500 at December 31, 197X, were being amortized over ten years.

(4) COMMITMENTS AND CONTINGENCIES

MSC has been named as defendant in a lawsuit initiated by an employee injured while working for MSC. The employee is seeking \$150,000 in damages from MSC. The suit is currently in the preliminary stages, and in the opinion of management and its legal counsel, the suit has no merit and will not result in any significant liability to MSC.

MSC has entered into a lease agreement for the rental of office space for branch offices. Under the lease agreement, MSC is required to make annual lease payments of \$45,000 through October 31, 19XX. Such lease payments are adjustable every two years due to the property tax escalation clause included in the lease. In addition, MSC has leased certain office equipment which requires annual payments of \$65,000 through 19XX.

(5) INCOME TAXES

MSC is exempt from Federal income taxes under Section 501(c)(3) of the Internal Revenue Service Code and from District of Columbia income taxes. In addition, MSC has been determined by the Internal Revenue Service not to be a "private foundation" within the meaning of Section 509(a) of the Code.

(6) 197Y FINANCIAL INFORMATION

The amounts shown for 197Y in the accompanying Statement of Support and Expense and Changes in Fund Balances are included to provide a basis for comparison with 197X and present summarized totals only. Accordingly, the 197Y amounts are not intended to present all information necessary for a fair presentation in accordance with generally accepted accounting principles.

(7) MANAGEMENT/ADMINISTRATIVE AND GENERAL, AND FUND-RAISING COSTS

MSC estimates its management/administrative and general costs (which include overall direction, accounting, budgeting, general Board activities and related items) were approximately \$330,000 in 197X and \$250,000 in 197Y. In addition, MSC has determined that fund-raising costs are not material.

Note: These footnotes and those reflected in Appendices I and II are purely illustrative in nature and should be read in that context. No LSC policies are established herein. The appropriate disclosure required by generally accepted accounting principles must be made for each program individually.

CONTINUED

4 OF 5

ILLUSTRATIVE AUDITOR'S SUPPLEMENTAL LETTER

ECONOMIC LEGAL AID CORPORATION
RECIPIENT NUMBER 300100

AUDITOR'S COMMENTS FOR
YEAR ENDED DECEMBER 31, 197X

March 15, 197Z

To the Board of Directors of
Economic Legal Aid Corporation:

We have examined the financial statements of Economic Legal Aid Corporation ("ELAC") for the year ended December 31, 197X, and have issued our report thereon dated March 15, 197Z. As a part of our examination, we reviewed and tested ELAC's system of internal accounting control to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards. Under these standards the purpose of such evaluation is to establish a basis for reliance thereon in determining the nature, timing, and extent of other auditing procedures that are necessary for expressing an opinion on the financial statements.

The objective of internal accounting control is to provide reasonable, but not absolute, assurance as to the safeguarding of assets against loss from unauthorized use or disposition, and the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a system of internal accounting control should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management.

There are inherent limitations that should be recognized in considering the potential effectiveness of any system of internal accounting control. In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes of judgment, carelessness, or other personal factors. Control procedures whose effectiveness depends upon segregation of duties can be circumvented by collusion. Similarly, control procedures can be circumvented intentionally by management with respect either to the execution and recording of transactions or with respect to the estimates and judgments required in the preparation of financial statements. Further, projection of any evaluation of internal accounting control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions and that the degree of compliance with the procedures may deteriorate.

Our study and evaluation of ELAC's system of internal accounting control for the year ended December 31, 197X, which was made for the purpose set forth in the first paragraph above, would not necessarily disclose all weaknesses in the system. However, during such study and evaluation certain matters came to our attention. All of the matters discussed herein were considered during our examination of the financial statements as of December 31, 197X, and they do not modify our opinion.

These matters will be considered by us in connection with subsequent examinations. Our study and evaluation, which included the areas specified in the Legal Services Corporation's "Audit and Accounting Guide for Recipients and Auditors" issued in August 1976 and revised in May 1977, disclosed the following matters that we would like to call to your attention.

1. Suggestions for improving internal control procedures:
 - a. The petty cash fund is not maintained on an imprest basis. With an imprest system, control over this fund would be facilitated and improved. Also, the ability to check compliance could be facilitated if the petty cash fund were established at a fixed amount and the petty cash custodian were required to retain cash and vouchers equal to the fixed amount. Reimbursement of the petty cash fund should be made for the exact amount of the petty cash vouchers being submitted for reimbursement.
 - b. Checks to reimburse the petty cash fund are made payable to "Cash." Checks written in this manner are fully negotiable should they be misplaced or stolen. This risk can be eliminated by having petty cash reimbursements made payable to "Martha Jones -- Petty Cash Custodian."
 - c. Currently, one employee writes checks, maintains the cash disbursements journal and receives and reconciles bank statements. We recognize that because of the limited number of personnel, total segregation of duties is not practicable or expedient. However, we believe internal control could be strengthened without undue interruption if bank reconciliations were assigned to another employee who would also initially receive the unopened statements.
 - d. Invoices are not canceled when paid but are simply filed away with the check copy attached. In order to eliminate the possibility of the double payment of an invoice, we recommend that all supporting documents be canceled through the use of a "Paid" stamp or by clearly marking the invoice "Paid" by hand.
 - e. ELAC does not maintain payroll withholding authorizations for employees. State and Federal laws require that all employers maintain these authorizations. Authorization forms should be obtained from the applicable government agencies and completed by all employees.
2. Significant and unusual transactions noted during the accounting period:
 - a. The Director of ELAC acted, in fiscal 197X, as a referee for the Fairfax County courts one day a month. The fees he received for these services were turned over to ELAC and recorded in the general fund. A proportionate amount of his salary for this time was charged to the general fund.

- b. In addition to the value recorded in the financial statements for the law library, ELAC has out-of-date law books which would have an approximate value, were they updated, of \$5,100. Management estimates it will cost \$2,500 to update these volumes. Since these sets have no current value to ELAC, no amount has been recorded for them in the financial statements.
 - c. At various times throughout 197X and 197Y, ELAC borrowed noninterest-bearing funds from other programs due to temporary cash shortages. These borrowings amounted to \$12,500 and \$13,900 from the Richmond Legal Aid Society for fiscal 197Y and 197X, respectively, and \$3,500 from the Fairfax County Economic Action Development Studies Program. All amounts were repaid to the lenders in the same year the funds were received.
 - d. The office space, currently being rented by the program is owned by ELAC's board chairman. The annual rental charge for similar office space in the area is substantially higher than the rates charged ELAC.
3. ELAC is in compliance with the financial and accounting conditions of the grant except as follows:
 - a. During the year, ELAC sold equipment for \$1,800 without obtaining the Regional Director's approval for the sale. Approval by the Regional Director is required when proceeds exceed \$500.
4. Costs incurred under the LSC grant were tested by us in accordance with generally accepted auditing standards to the extent such costs came within the scope of our work necessary to issue an opinion on the financial statements. As a result of the examination, \$728 of costs have been listed on Exhibit I for a determination by LSC as to whether such costs are in accordance with the criteria of Chapter 4 of the Guide or with the terms of the LSC grant.
5. We reviewed with the Program Director the comments disclosed in the previous audit's supplemental letter. Except for the items listed below, steps had been taken to implement all suggestions by December 31, 197X.
 - a. Items (a) and (b) of Section 1 of this letter were included in the previous supplemental letter.
 - b. Support for a \$250 airplane ticket, noted as unsupported in the previous report, has not been obtained by the program nor has this exception been cleared to the satisfaction of the LSC Regional Director.

This letter of comments is furnished solely for the information of management and the Legal Services Corporation and is not to be used for any other purpose.

Very truly yours,

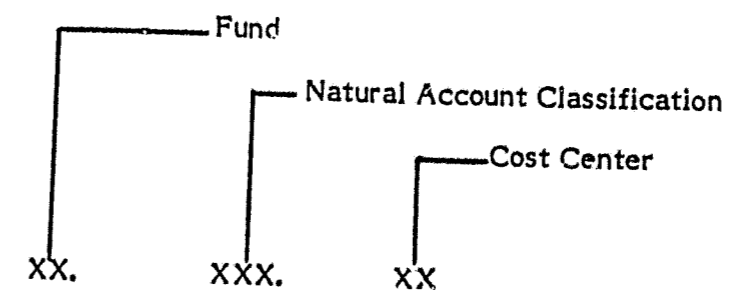
ILLUSTRATIVE CHART OF ACCOUNTS

MEDIUM-SIZED RECIPIENT

The following sample chart of accounts for a medium-sized recipient utilizes the chart of accounts concept described in paragraph 2-3. This chart of accounts demonstrates how account details can be used to accumulate financial information necessary for adequate reporting for both internal and external purposes. Also, it shows how fund or grant activity is accumulated for the various funding sources by assigning prefixes.

It is emphasized that this sample chart of accounts is for reference purposes only. It does not dictate the accounts and detail required of recipients, but instead should be used for guidance when a program is revising its chart of accounts. Each program must adopt a chart of accounts best suited to its needs.

The basic concept of this chart of accounts is diagrammed below.



The basic feature of the chart of accounts is the natural account classification. It is organized for "summary classification" for financial statement presentation and the accumulation of detail activity. The fund and cost center coding is as follows:

<u>FUNDS</u>	<u>COST CENTERS</u>
00 Balance Sheet	01 General and
01 LSC	Administrative
02 ACE Foundation	02 Main office
03 HEW	03 Senior Citizens
04 Miscellaneous Grants and Contracts	Office
05 General Fund	
06 Donated Items	
07 Property	

The numerical sets assigned to the natural account classifications are as follows:

100	Assets
200	Liabilities
300	Fund Balances
400	Support
500	Expenses
600	
700	Asset Activity

ASSETS

	<u>DETAIL ACCOUNT NUMBER</u>
100 Cash Accounts	
General Disbursements	101
Payroll - Imprest	102
Petty Cash - Imprest	103
110 Client Escrow Funds	110
120 Receivables	
LSC	121
ACE Foundation	122
HEW	123
Other	124

130 Investments	
Savings	131
Stock	132
Certificates of Deposit	133
140 Travel Advances to Employees	140
150 Prepaid Expenses	150
160 Furniture, Fixtures, and Equipment	160
170 Leasehold Improvements	170
180 Law Library	180
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ACCOUNTING PROCEDURES AND INTERNAL CONTROL CHECKLIST

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

The following checklist is provided as a guideline for recipient's management to direct attention to practicable revisions of accounting procedures or internal controls which can be made to strengthen, improve, or simplify the existing system. This checklist should not be considered all-inclusive nor are all items considered necessary for all recipients. This is an area where recipients should utilize the expertise of their auditors in a continuing relationship to maximize the services an auditor can provide. The items marked with an asterisk (*) are considered fundamental and essential elements of internal controls. There should be few legitimate reasons not to include these as part of each recipient's procedures.

A. General

- *1. Has a system of authorizations and approval been established to require appropriate managerial approval for all significant actions or financial transactions of the organization?
- *2. Has a chart of accounts been established to identify all accounts in the accounting system?
- *3. Does the organization use a double-entry accounting system?
- *4. Are transactions in the accounting records properly authorized, as evidenced by supporting documentation containing the appropriate approving official's signature?
- *5. Are bank accounts authorized by the Board of Directors?
- *6. Are employees and officers who handle assets or perform significant financial duties bonded?
- *7. Are budget controls established to allow the program director to adequately control expenditures?
- *8. Are procedures established to provide a clean cutoff between periods with respect to the recording of support and expenses?
9. Has a general policy with respect to insurance coverage been defined and procedures instituted to insure that all significant business risks have been covered? Is insurance coverage periodically reviewed with a competent insurance agent?
- *10. Are journal entries adequately explained, supported, and approved by a responsible officer or employee?
11. Does the recipient prepare and use an annual overall financial plan or operating budget to allocate its resources and provide a system of evaluation and control?
12. Does the recipient have an accounting and financial manual that stipulates the financial duties of employees?
13. Is there an organization chart to show definite lines of responsibility and authority?
14. Are employees required to take annual vacations, and are duties assigned to others in the absence of an employee on vacation or otherwise absent?
15. Are the accounting policies followed by the organization in agreement with those stipulated by their grants and contracts?

16. Where feasible, are common or indirect costs accumulated into cost pools for later allocation of costs to each project, contract, and grant?
17. Are bases used to allocate cost pools equitable and approved by the various funding organizations?

B. Personnel and Payroll

- *1. Are salary and wage rates approved by a responsible officer in writing and are procedures adequate to provide that employees are paid in accordance with approved budget, wage, or salary rates?
- *2. Do procedures provide for the proper withholding and payment of applicable Federal, state, and local income and payroll taxes?
3. Are employees furnished information as to their earnings, deductions from earnings, etc., on their payroll check stubs?
4. When employees are initially hired, do procedures provide for reference checks and confirmation of prior salary and employment data, and is documentation made of these procedures and maintained as part of the employees' files?
5. Are payroll checks signed by persons having no part in preparing the payroll?
6. Are there personnel policies prohibiting employment of individuals which could result in nepotism or conflict of interest?
7. Are the payroll bank accounts reconciled by employees who have no other functions with respect to the payrolls?
8. Do procedures followed in reconciling payroll bank accounts include the checking of names on pay checks against payroll records and the examination of endorsements on checks?
- *9. Is the reconciliation reviewed critically each month by an officer or responsible employee?
10. Is an independent test made of hours, rates, or other bases of payment by reference to attendance records, employment authorizations, approved rate changes, etc. by someone not connected with the preparation or distribution of the payroll?

11. Are personnel policies established in writing?
- *12. Are employees' hours worked approved by the employees' supervisor?
- *13. Are records kept on personnel actions including hiring, promotion, dismissal, and resignation of both full-time and part-time employees?
14. Are labor hours charged (distributed) to projects, contracts, and grants based on time distribution records, which identify the total time actually spent by all individuals who charged time directly to projects, contracts, and grants?
15. Are payroll totals checked against labor distribution totals which are compiled from the original time records?
- *16. Are payrolls disbursed from an imprest bank account restricted for that purpose?
- *17. Do the personnel and/or payroll records include the following or similar records:
 - a. An attendance record?
 - b. Vacation, sick and other excused leave records?
 - c. Individual payroll record form?
 - d. A payroll register?
 - e. Notification concerning appointments, terminations, position classifications, and salary rates?
18. When employees work overtime, are there procedures to provide for (where applicable):
 - a. Authorizing and paying overtime only to employees entitled to receive overtime pay?
 - b. Recording earned and used compensatory time in lieu of overtime pay?
19. Where duties require employees to spend time away from their offices, do they prepare reports disclosing their weekly or monthly activities?
20. Are duties of those preparing the payroll rotated?
- *21. Is a "tax return calendar" or other method used to insure timely preparation and filing of various payroll tax returns?

C. Property Control

- *1. Are records maintained for fixed assets purchased in excess of \$100 which provide the following information:
 - a. Date of purchase?
 - b. Description of item, including model and serial number?
 - c. Cost of item and check number of disbursement?
 - d. Identification of funds used to purchase assets?
 - e. Depreciation lives assigned to assets?
 - f. Identification number and location of asset?
- *2. Are fixed-asset records for items with a cost in excess of the capitalization limit balanced to the general ledger control accounts periodically?
- *3. Are fixed assets tagged for easy identification with fixed-asset records?
- *4. Are physical inventories taken yearly and compared to fixed-asset records?
- *5. Are adjustments (including adjustments resulting from theft, retirement and sale of assets) to fixed-asset records and general ledger control accounts reviewed and approved by an appropriate organization employee or officer who does not have responsibility for maintaining fixed-asset records?

D. Procurement

1. Are supplies in storage reasonably protected from theft, deterioration and damage?
2. Do procedures provide for the solicitation of prices for purchase, rent, and/or lease of fixed assets?
3. Do procedures provide that consideration will be given to the cost advantages of buying versus renting equipment and other nonexpendable property?
4. Are approved vendor lists used for recurring purchases?
- *5. Does the recipient have a systematic method for determining what supplies are needed and in what quantities?

6. Are prenumbered purchase orders used and appropriate authorization obtained prior to purchase, rent, or lease of equipment and supplies?
7. Are receiving documents prepared (e.g., receiving log or ticket) and inspection of goods made without reference to purchase orders?
8. Are invoices, purchase orders and receiving documents compared and accounted for by a person not having any other purchase or receiving functions?
9. Are purchase orders outstanding for long periods of time investigated?

E. Legal Consultants/Contract Services

- *1. Are procedures in effect to provide for formal approval by the Regional Director, Board of Directors, or other high level authority, of consultant and contract service agreements over prescribed limits?
- *2. Are there adequate procedures to insure that all necessary funding source approvals are obtained prior to entering into contracts?
3. Do procedures provide for the solicitation of proposals or bids prior to contract award?
- *4. Are contracts written so that the services to be rendered are clearly defined?
5. Does the organization have controls for determining whether contracts are properly executed?

F. Travel

- *1. Does the organization have formal written travel policies?
- *2. Is adequate support (e.g., lodging receipts, air fare tickets) received from an employee before reimbursement for travel expenses is made?
- *3. Are there adequate controls over the accounting for advances and reimbursements for travel expenses made to employees?
4. For out-of-town travel, do employees prepare trip reports documenting the reasons and/or the results of the trip?

G. Controls over Cash Disbursements

- *1. Are all checks prenumbered?
- *2. Are all payments, except those made from petty cash, made by check?
- *3. Are persons who sign checks designated by the Board of Directors?
- *4. When checks (except payroll) are presented for signatures, are the supporting vouchers and invoices also presented?
- *5. Are there appropriate controls to assure that payments are made only for allowable items of costs, as defined by the terms of the respective contracts and grants?
- *6. Are there procedures to insure that checks are never drawn payable to:
 - a. Officers or employees with the understanding that the cash is to be used for organization purposes (other than for travel reimbursements, petty cash reimbursements, etc.)?
 - b. Cash, bearer, or similar payee which renders the check payable to bearer?
 - c. Other payee when the payee named is not intended as the party to retain the funds?
7. Are written accounting policies and procedures established to describe the accounting system and assure that similar transactions are processed consistently?
- *8. Are there procedures to insure that blank checks are never signed in advance?
- *9. Have there been procedures adopted to insure that the names of individuals once authorized as check signers are not retained in the signature lists on file with the banks after the individuals have left the employ of the recipient or have been transferred to duties incompatible with check signing?
- *10. Is there an appropriate system for filing checks, check copies, and supporting documents; and are supporting documents filed in such a manner so as to be readily located?
11. Are supporting documents marked paid or otherwise canceled and the check number and date of payment indicated to prevent duplicate payments?

12. Is a check protector used?
13. Where a mechanical check signer is used, is the signature die under adequate control?

H. Controls Over Cash Receipts

- *1. Are cash receipts deposited currently and intact?
- *2. Does the accounting system identify the receipt and expenditure of program funds separately for each contract and grant requiring separate reporting?
3. Are bank-stamped duplicate deposit slips compared with the Cash Receipts Journal?
- *4. Does the employee who opens the mail list the receipts in detail in the Cash Receipts Journal and is this record used by someone independent of other accounting functions to verify the amount recorded in the general ledger and deposited in the bank?

I. Bank Reconciliation Procedures

- *1. Are bank accounts reconciled monthly?
2. Does the reconciliation procedure include:
 - *a. Comparison of checks with cashbook as to number, date, payee, and amount?
 - b. Examination of signatures and endorsements, and procedures for the return of inadequately endorsed checks, paid by banks, to the banks for proper endorsements?
 - *c. Examination of voided checks?
 - *d. Accounting for serial numbers of checks?
 - e. Comparison of dates and amounts of daily deposits as shown by the cash receipts records with the bank statements?
 - f. Test-check of details shown on authenticated duplicate deposit slips obtained directly from the banks against the corresponding details in the cash receipts records?

- *3. Are bank statements and paid checks delivered unopened directly to the person preparing the reconciliation?

J. Segregation of Duties

1. Do the bookkeeper's duties exclude the following functions:
 - a. Receive cash or checks?
 - b. Open the incoming mail?
 - c. Prepare bank deposits?
 - d. Sign checks?
2. Does an individual other than the person who prepares the bank deposit slip actually deposit the cash in the bank?
3. Is the mail opened by a person who does not prepare the bank deposit?
4. Do the duties of the person preparing the bank reconciliation exclude
 - a. Posting to the books of account?
 - b. Handling cash?
 - c. Signing checks?
5. Are checks, after being signed, controlled and mailed out by an individual who does not have any other accounting duties?

K. Petty Cash Controls

- *1. Is responsibility for the petty cash fund vested in only one person?
- *2. Are petty cash vouchers
 - a. Required for each petty cash disbursement?
 - b. Signed by the recipient of the cash disbursed?
 - c. Executed in ink?
 - d. Approved by a responsible person?
- *3. Are petty cash disbursements evidenced by properly approved supporting data?

- *4. Are supporting data for petty cash disbursements checked at time of reimbursement?
- *5. Are petty cash reimbursements made payable directly to the petty cash custodian by name rather than to cash, bearer, etc.?
- *6. Are petty cash funds maintained on an imprest basis?
- *7. Are there procedures to insure that the cash receipts are not comingled with the petty cash fund?
8. When the petty cash fund is reimbursed, is a notation of payment made on supporting data to prevent duplicate payment?
9. Is the petty cash bank account reconciled by an employee independent of the petty cash custodian?
10. Are petty cash funds audited by surprise counts by an independent person to insure the fund does not include personal checks, IOU's etc., and that the petty cash fund balances?

L. Client Deposits Controls

- *1. Are client funds deposited into a bank account used only for the client's intended purpose?
- *2. Was the client trust bank account approved by the Board of Directors?
3. Are two signatures required on checks?
4. Is the account reconciled by an individual not involved with client deposit operations?
- *5. Are prenumbered receipts given to clients for all checks and cash received?
- *6. Are the following records maintained for the accounts?
 - a. A receipts book with pre-numbered receipts.
 - b. A cash disbursements journal.
 - c. A detailed record of the activity for each client's deposit.

Appendix VII

ACCOUNTING FOR PROPERTYCapitalization

The following illustrates the accounting entries to record the purchase of equipment using LSC funds. The cost of the equipment is assumed to be \$1,000 and the account numbers are taken from the chart of accounts which is illustrated in Appendix V.

1. At the time of purchase and disbursement of cash:

Debit:	Acquisition of property (A/C 1.700)	\$1,000
Credit:	Cash (A/C 101)	\$1,000

For internal accounting purposes this account is treated as an expense during the year and closed to LSC fund balance along with all support and expense accounts at year end.

2. A second entry is required (normally made quarterly or at the end of the year) to record the asset:

Debit:	Furniture, Fixtures, Equipment (A/C 150)	\$1,000
Credit:	Fund balance - Property (A/C 320)	\$1,000

When a recipient has historically expensed property and such property is still in use, an entry to capitalize these assets is made by recording the furniture, fixture or equipment at its original cost, less accumulated depreciation. In the absence of accurate historical cost records, an appraisal or other estimate of the cost will be satisfactory. A

cost-based appraisal contemplates recording property on the basis of catalog prices, vendor price lists, or another reasonable source. Each recipient should exercise judgment in using a reasonable method to determine an amount to be capitalized.

Depreciation

LSC suggests that the straight-line depreciation method, with the following guidelines for estimated useful lives, be followed. Internal Revenue Service guideline lives or other criteria may be used if a recipient believes the criteria below are not appropriate for the program's assets.

Furniture, fixtures, and equipment	5 to 10 years
Leasehold improvements	Term of lease or life of improvements whichever is shorter

Using the earlier example, assuming a useful life of five years, no salvage value, and depreciation computed on the straight-line method, depreciation on the equipment for one year is \$200 (\$1,000 divided by 5) and would be recorded in the property fund as follows:

Debit:	Depreciation and Amortization Expense (A/C 7.620)	\$200
Credit:	Accumulated Depreciation - Furnitures, Fixtures and Equipment (A/C 160)	\$200

Depreciation may be computed on an item-by-item or group basis. The item-by-item basis is probably the simplest method when a program has less than fifty items. The group basis consolidates similar type items (i.e. - all furniture, all office equipment, etc.) purchased during a year (vintage-year) and considers them as one group (i.e., furniture, equipment,

etc.). Therefore, depreciation records are maintained for the group instead of each individual item within the group. The clerical effort required is significantly reduced using the "vintage year" method when there are a large number of assets.

However, a record detailing original cost of each item within the group should be maintained by year to be used if particular items are sold or retired before they are fully depreciated (this subject will be discussed later). Depreciation for groups of assets is computed identically to depreciation for an individual item which was illustrated in the previous paragraph.

Sales

The net gains or losses from the sale of property and equipment should be reported as revenue or expense in the property fund. Gain or loss on a transaction is defined as the difference between the sales proceeds, and the net book value of the asset (original cost reduced by accumulated depreciation to the date of sale).

Proceeds from the sale of property are not, as a general policy, required by LSC to be reinvested in property. Proceeds, if not reinvested in property, should be transferred to the general fund balance and used for general program purposes which would not result in a permanent increase in annualized funding requirements. If significant proceeds are to be received (i.e., in excess of \$500) the regional director must approve the sale and disposition of the proceeds from the sale. The following illustrates the recording of a sale when a gain (Illustration 1) is realized or a loss (Illustration 2) is incurred:

Illustration 1 - Sale of equipment at more than net book value.

- Assumptions:
- Equipment was originally purchased for \$100.
 - At time of sale, accumulated depreciation was \$50.
 - Asset was sold for \$60.

Two entries are required to record the transaction.

- The first entry is to record the receipt of the sales proceeds

Debit:	Cash (A/C 101)	\$ 60
	Credit: Proceeds from sale (A/C 5.720)	\$ 60

- The second entry is made at year end to compute the gain or loss and record the transaction in the property fund.

Debit:	Accumulated depreciation - furniture, fixtures and equipment (A/C 160)	\$ 50
Debit:	Property fund balance (A/C 320)	\$ 60
	Credit: Furniture, Fixtures & Equipment (A/C 150)	\$ 100
	Credit: Gain on sale (A/C 7.730)	\$ 10

Illustration 2 - Sale of equipment at less than net book value.

- Assumptions: Same as Illustration 1 except that cash received was only \$40.

- The first entry to record the receipt of the sales proceeds

Debit:	Cash (A/C 101)	\$ 40
	Credit: Proceeds from sale (A/C 5.720)	\$ 40

- The second entry to record the loss

Debit:	Accumulated depreciation - Furniture, Fixtures, & Equipment (A/C 160)	\$ 50
Debit:	Property fund balance (A/C 320)	\$ 40
Debit:	Loss on sale (A/C 7.730)	\$ 10
	Credit: Furniture, fixtures, equipment (A/C 160)	\$ 100

Vintage-Year Adjustments

When the group (vintage-year) method is used, gains or losses are recorded similarly. If an item is included in a group being depreciated over ten years, and four years depreciation has been recorded at the time of the sale, then the basis (i.e., cost less accumulated depreciation) for the item is 6/10 of its historical cost.

It should be noted that when an item is removed from a "group" account, the annual depreciation of that group must be adjusted for the item deleted. For example, assume a group originally consisted of ten items costing \$1,000 in total and depreciated over ten years (depreciation expense is \$100 per year). If one item costing \$100 was sold after five years (50% of useful life) the computation of subsequent years' depreciation would be as follows:

$$\text{Cost of remaining property } (\$1,000 - \$100) = \$900$$

$$\text{Divided by useful life of 10 years} = \$90 \text{ annual depreciation}$$

Write-Offs

Amounts required to be written off through abandonment or other loss should be recognized as expense in the property and equipment fund balance. The following illustrates the write-off of equipment originally costing \$100 with accumulated depreciation of \$75 at date of abandonment:

Debit:	Loss on abandonment of equipment (A/C 7.730)	\$ 25
Debit:	Accumulated depreciation - Furniture, Fixtures, Equipment (A/C 160)	\$ 75
Credit:	Furniture, Fixtures, Equipment (A/C 150)	\$ 100

Purchase of Property with Debt

The accounting when property is purchased entirely or partially with debt follows the same reasoning as discussed above. The total cost of the property and the related debt must be recorded in the property fund. Periodic activity relating to the retirement of indebtedness and interest payments should be recorded in the general or other operating fund from which payments are made. Interest payments should be included as an element of expense in the statement of support and expenses and principal reductions should be classified within the changes to fund balances. The property fund should reflect only the reduction in debt and corresponding increase in the property fund balance. Depreciation entries are the same as described above.

Appendix VIII

Functional Classification of Expenses

The Accounting Standards Subcommittee on Non-profit Organizations of the American Institute of Certified Public Accountants is currently developing recommendations with respect to accounting and reporting by non-profit organizations which were not previously covered by industry guides. Legal services programs are included in this category. The recommendations from this Committee are contained in a discussion draft for public comment of a tentative "Statement of Position" released in February 1977. After this statement of position becomes effective (probably in late 1978), all CPA's will be required to qualify their opinion in the event a program's financial statements are not presented in accordance with the accepted principles.

This appendix has been prepared to present the financial statements shown in Appendix III (Multi-Service Corporation) under the proposed principles. The statements should be reviewed in conjunction with Appendix III to allow each program to assess the changes that will be required to comply with the new "Statement of Position" when it becomes effective. The following table highlights the different features of Multi-Service's financial statements.

StatementChanges

Balance Sheet

Same as previously reflected in Appendix III

Statement of Support and Expenses and Changes in Fund Balances

Presented on a functional expense basis. An additional statement of functional expenses analyzed by natural

functional expenses analyzed by natural expense category, and a statement of support and expenses analyzed by restricted grants or contracts (Schedule I) is presented.

Notes to financial statements Same as previously reflected in Appendix III.

The following financial statements illustrate Multi-Service Corporation's annual report presented on a functional basis of accounting.

MULTI-SERVICE CORPORATION

BALANCE SHEET

AS OF DECEMBER 31

<u>A S S E T S</u>				<u>LIABILITIES AND FUND BALANCES</u>	
	<u>197X</u>	<u>197Y</u>		<u>197X</u>	<u>197Y</u>
CURRENT ASSETS:			LIABILITIES (all current):		
Cash	\$ 20,400	\$ 22,000	Accounts payable	\$ 58,400	\$ 57,500
Certificates of deposit, 5%	132,000	115,000	Accrued expenses	57,800	51,300
Client escrow funds	8,500	10,300	Employee withholding payables	4,500	1,200
Receivables -			Client trust deposits	8,500	10,300
Legal Services Corporation	40,400	45,900			
NEW	16,000	10,200	Total liabilities	129,200	120,400
Brown Foundation	12,300	11,500			
Travel advances to employees	8,500	5,000			
Prepaid expenses	7,300	3,200			
Total assets	245,400	223,100			
			COMMITMENTS AND CONTINGENCIES		
PROPERTY (Note 1):			(Note 4):		
Furniture, fixtures, equipment (net			FUND BALANCES:		
of accumulated depreciation of			Restricted -		
\$234,500 in 197X and \$210,600			Legal Services Corporation	9,400	49,400
in 197Y)	272,200	181,100	Brown Foundation	40,000	2,000
Law library (net of accumulated			Unrestricted	66,800	51,200
depreciation of \$35,000 in 197X			Property	362,200	266,100
and \$22,000 in 197Y)	90,000	85,000	Total fund balances	478,400	368,800
Total property	362,200	266,100			
			Total liabilities and	\$607,600	\$489,200
Total assets	\$607,600	\$489,200	fund balances	*****	*****

The accompanying notes are an integral part of this balance sheet.

MULTI-SERVICE CORPORATION

STATEMENT OF SUPPORT, REVENUE AND EXPENSES AND CHANGES IN FUND BALANCES

YEAR ENDED DECEMBER 31, 197X WITH COMPARATIVE TOTALS FOR 197Y

	197X			Total All Funds	
	Current Funds			197X	197Y
	Unrestricted	Restricted	Property		
SUPPORT AND REVENUE:					
Grants and contracts (Notes 1 and 2)	\$ -	\$2,631,000	\$ -	\$2,631,000	\$2,375,000
Contributions (Note 1)	220,000	-	-	220,000	180,000
Interest	2,000	20,000	-	22,000	15,000
Donated property and services (Note 1)	18,000	-	17,000	35,000	38,500
Gain on sale of equipment	-	-	14,000	14,000	21,600
Total support	240,000	2,651,000	31,000	2,922,000	2,630,100
EXPENSES (Note 1):					
Program services -					
Senior citizens	66,100	471,000	5,100	542,200	498,000
Domestic relations	37,100	257,000	3,100	297,200	281,000
General law	90,200	1,542,000	10,800	1,643,000	1,547,000
Total program services	193,400	2,270,000	19,000	2,482,400	2,326,000
Supportive services -					
Management and general	33,100	292,000	4,900	330,000	220,600
Total expenses	226,500	2,562,000	23,900	2,812,400	2,546,600
EXCESS OF SUPPORT AND REVENUE OVER EXPENSES	13,500	89,000	7,100	109,600	83,500
FUND BALANCE, beginning of year	51,300	51,400	266,100	368,800	285,300
OTHER CHANGES IN FUND BALANCE:					
Acquisition of property and equipment	(18,000)	(91,000)	109,000	-	-
Transfer of proceeds from sale of equipment	20,000	-	(20,000)	-	-
FUND BALANCE, end of year	\$ 66,800	\$ 49,400	\$362,200	\$ 478,400	\$ 368,800

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The accompanying notes are an integral part of this statement.

MULTI-SERVICE CORPORATION

STATEMENT OF FUNCTIONAL EXPENSES

YEAR ENDED DECEMBER 31, 197X WITH COMPARATIVE TOTALS FOR 197Y

	Program Services			Total	Supporting Services Management and General	Total Expenses	
	Senior Citizens	Domestic Relations	General Law			197X	197Y
Salaries and wages -							
Lawyers	\$279,000	\$158,000	\$1,029,000	\$1,466,000	\$153,000	\$1,624,000	\$1,475,000
Non-lawyers	36,900	17,000	94,000	147,900	28,100	176,000	133,000
Employee benefits (Note 3)	22,500	19,000	129,000	170,500	21,000	191,500	171,400
	<u>338,400</u>	<u>194,000</u>	<u>1,252,000</u>	<u>1,784,400</u>	<u>207,100</u>	<u>1,991,500</u>	<u>1,834,400</u>
Legal consultants	39,000	12,000	98,000	149,000	29,000	178,000	102,000
Contract services	42,000	10,500	67,000	119,500	10,200	129,700	110,000
Travel	18,000	5,900	42,000	65,900	11,600	77,500	61,700
Space and occupancy	73,600	45,000	61,400	180,000	40,000	220,000	213,000
Office expenses	10,100	11,000	49,000	70,100	15,400	85,500	54,500
Equipment rental	12,500	12,500	53,000	78,000	7,800	85,800	36,900
Litigation costs	3,500	3,200	9,800	16,500	4,000	20,500	14,200
Total expense before depreciation	<u>537,100</u>	<u>294,100</u>	<u>1,632,200</u>	<u>2,463,400</u>	<u>325,100</u>	<u>2,788,500</u>	<u>2,526,500</u>
Depreciation expense	5,100	3,100	10,800	19,000	4,900	23,900	23,100
Total expenses	<u>\$542,200</u>	<u>\$297,200</u>	<u>\$1,643,000</u>	<u>\$2,482,400</u>	<u>\$330,000</u>	<u>\$2,812,400</u>	<u>\$2,549,600</u>

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The accompanying notes are an integral part of this statement.

MULTI-SERVICE CORPORATION

Schedule 1

STATEMENT OF SUPPORT, REVENUE AND EXPENSES OF RESTRICTED FUNDS
FOR THE YEAR ENDED DECEMBER 31, 197X

	Legal Services Corporation	HEW	Brown Foundation	Miscellaneous Grants	Total
SUPPORT:					
Grants and contracts	\$1,250,000	\$881,000	\$400,000	\$100,000	\$2,631,000
Interest income	16,000	-	4,000	-	20,000
	1,266,000	881,000	404,000	100,000	2,651,000
EXPENSES:					
Salaries and wages					
Lawyers	829,000	444,000	200,000	61,000	1,534,000
Non-lawyers	60,000	50,000	21,000	5,000	136,000
Employee benefits	98,000	53,000	23,000	6,000	180,000
Legal consultants	987,000	547,000	244,000	72,000	1,850,000
Contract services	38,000	100,000	16,000	4,000	158,000
Travel	30,000	82,500	7,000	2,000	121,500
Space and occupancy	29,000	20,500	14,400	4,000	67,900
Office expenses	106,000	45,000	39,000	10,000	200,000
Equipment rental	31,500	22,000	13,600	3,000	70,100
Litigation costs	34,000	26,000	15,000	3,000	78,000
	7,500	6,000	1,000	2,000	16,500
	1,263,000	849,000	350,000	100,000	2,562,000
EXCESS (DEFICIENCY) OF SUPPORT OVER EXPENSES	3,000	32,000	54,000	-	89,000
FUND BALANCE, beginning of year	49,400	-	2,000	-	51,400
OTHER CHANGES IN FUND BALANCE:					
Acquisition of property and equipment	(43,000)	(32,000)	(16,000)	-	(91,000)
FUND BALANCE, end of year	\$ 9,400	\$ -	\$ 40,000	\$ -	\$ 49,400

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MULTI-SERVICE CORPORATION
NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 197X AND 197Y

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Operations -

Multi-Service Corporation ("MSC") is a nonprofit corporation organized for the purpose of providing legal assistance in noncriminal proceedings or matters to persons financially unable to afford legal assistance in the metropolitan Washington, D.C. area.

Legal Services Corporation ("LSC"), a nonprofit corporation organized by Congress to administer a nationwide legal assistance program, and the Brown Foundation provide continued support to MSC through annual grants.

(b) Grant and Contract Support -

MSC recognizes grant/contract funds from LSC and the Brown Foundation as support on a straight-line basis over the grant/contract period. Funds remaining unused at the end of an accounting period are carried in the applicable fund balance. In accordance with the normal policies of LSC and the Brown Foundation, MSC may retain unexpended funds for use in future periods provided expenses incurred are in compliance with the specified terms of each grant/contract, as defined. LSC and the Brown Foundation may, at their discretion, request reimbursement for expenses or return of funds, or both, as a result of noncompliance by MSC with the terms of the grants/contracts. In addition, if MSC terminates its legal assistance activities, all unexpended funds are to be returned to the funding sources.

MSC recognizes contract funds from the Department of Health, Education, and Welfare ("HEW") as support when eligible costs are incurred. A receivable is recognized to the extent contract support earned exceeds cash advances. Conversely, a liability (unearned support) is recorded when contract cash advances exceed support earned.

(c) Contributions -

Contributions represent cash donations to the program from private organizations and individuals and are recognized as support when received.

(d) Furniture, Fixtures, and Equipment -

Property and equipment acquired with LSC, Brown Foundation, and HEW funds are considered to be owned by MSC while used in the program or in future authorized programs. However, the funding sources have a reversionary interest in the property as well as the right to determine the use of any proceeds from the sale of assets purchased with their respective funds.

MSC follows the practice of capitalizing all expenditures for property and equipment in excess of \$100. Depreciation of all property and equipment is computed on a straight-line basis over the estimated service lives of the assets. Amortization of leasehold improvements is computed on a straight-line basis over the terms of the lease since that period is shorter than the estimated service life. The following lives have been assigned to the capitalized assets.

Building	50 years
Improvements to land and buildings	10 to 50 years
Furniture, fixtures, and equipment	5 years

(e) Law Library -

MSC capitalizes the costs of library books and multiple volume sets of law books. MSC estimates the salvage value of its law library at approximately half of the original cost. Depreciation is computed on the straight-line basis over the estimated service life which management believes approximates 15 years.

(f) Donated Property and Services -

Property donated to MSC is recorded at its market value at the time of receipt. Donated property valued at \$17,000 is included in the accompanying financial statements for 197X.

Donated services valued at \$18,000 represent services rendered by various attorneys in the Washington, D.C. area at no charge to MSC in connection with MSC's legal assistance program. The value of donated services is based upon an estimated average fee normally charged by the professionals rendering the services.

Donated property and services are recognized both as support and expenses and therefore, do not affect MSC's fund balances.

(g) Allocation of Expenses -

In some cases, common expenses are incurred which support the work performed under more than one grant or contract. Such expenses are allocated among LSC, HEW, and the Brown Foundation as agreed by these funding sources or, in the absence of an agreement, on the basis which appears most reasonable to MSC. Space costs shown in the accompanying financial statements were allocated 46% to LSC, 23% to HEW, 23% to Brown Foundation, and 8% to the general fund, a basis which has been approved by the funding sources. Portions of office expenses and equipment rental have been allocated 50% to LSC, 25% to HEW, 15% to the Brown Foundation, and 10% to the general fund, approximately in the ratio of number of employees authorized by each funding source.

(2) SUMMARY OF FUNDING

MSC is funded primarily through a grant from LSC, a contract with Brown Foundation, and a cost-reimbursable contract from the U.S. Department of Health, Education, and Welfare. The HEW contract expired on December 31, 197X, and was not extended. MSC's grant from LSC and its contract with Brown Foundation continue through June 30, 197Z, and March 31, 197Z, respectively. At December 31, 197X, MSC had remaining funds of \$750,000 for the LSC grant and \$125,000 for the Brown Foundation contract. The following information summarizes MSC's major grant and contract activity during 197X.

<u>Number</u>	<u>Period</u>	<u>Amount</u>	<u>197X Support</u>	<u>Unrecognized Support</u>
<u>LSC</u>				
100500 7Y-1	7/1/7Y- 6/30/7X	\$1,000,000	\$ 500,000	\$ -
100500 7X-1	7/1/7X- 6/30/7Z	<u>1,500,000</u>	<u>750,000</u>	<u>750,000</u>
		2,500,000	1,250,000	750,000
<u>HEW</u>				
10132	1/1/7Y- 12/31/7Z	1,900,000	881,000	3,000
<u>Brown Foundation</u>				
7501	6/30/7Y- 3/31/7Z	<u>875,000</u>	<u>400,000</u>	<u>125,000</u>
		<u>\$5,275,000</u>	<u>\$2,531,000</u>	<u>\$ 878,000</u>

In addition to its primary grant and contracts, MSC received and recorded the following as "Miscellaneous grants and contracts" in the accompanying financial statements.

<u>197X Support</u>	
United Way	25,000
City of Washington	50,000
Smith Foundation	15,000
Jones Foundation	10,000
	<u>\$100,000</u>

All funds are restricted to be used only for purposes authorized under the Legal Services Corporation Act of 1974. Legal Services Corporation, HEW, and Brown Foundation require a separate reporting of support and expenses and changes in fund balances applicable to their funds.

(3) PENSION PLAN

MSC has a noncontributory pension and disability plan for all full-time employees. MSC's policy is to fund normal costs and amortize past services costs on a current basis. Expenses of the plan in the accompanying financial statements were \$51,300 for 197X and \$47,200 for 197Y. As of December 31, 197X, the plan's net assets aggregated \$230,000 and the actuarially computed value of vested benefits were \$143,000. Unfunded past services costs of \$93,500 at December 31, 197X, were being amortized over ten years.

(4) COMMITMENTS AND CONTINGENCIES

MSC has been named as defendant in a lawsuit initiated by an employee injured while working for MSC. The employee is seeking \$150,000 in damages from MSC. The suit is currently in the preliminary stages, and in the opinion of management and its legal counsel, the suit has no merit and will not result in any significant liability to MSC.

MSC has entered into a lease agreement for the rental of office space for branch offices. Under the lease agreement, MSC is required to make annual lease payments of \$45,000 through October 31, 19XX. Such lease payments are adjustable every two years due to the property tax escalation clause included in the lease. In addition, MSC has leased certain office equipment which requires annual payments of \$65,000 through 19XX.

(5) INCOME TAXES

MSC is exempt from Federal income taxes under Section 501(c)(3) of the Internal Revenue Service Code and from District of Columbia income taxes. In addition, MSC has been determined by the Internal Revenue Service not to be a "private foundation" within the meaning of Section 509(a) of the Code.

(6) 197Y FINANCIAL INFORMATION

The amounts shown for 197Y in the accompanying Statement of Support and Expense and Changes in Fund Balances are included to provide a basis for comparison with 197X and present summarized totals only. Accordingly, the 197Y amounts are not intended to present all information necessary for a fair presentation in accordance with generally accepted accounting principles.

Note: These footnotes and those reflected in Appendices I and II are purely illustrative in nature and should be read in that context. No LSC policies are established herein. The appropriate disclosure required by generally accepted accounting principles must be made for each program individually.

B I B L I O G R A P H Y

1. Accounting Advisory Committee. Report to the Commission on Private Philanthropy and Public Needs. Author, 1974.
2. American Institute of Certified Public Accountants. Audits of Voluntary Health and Welfare Organizations. New York Author, 1974.
3. American Institute of Certified Public Accountants. Journal of Accountancy, Accounting and Auditing. New York, January, 1976.
4. Gross, Malvern J., Jr. Financial & Accounting Guide for Non-profit Organizations. New York, Ronald Press Co., 1974.
5. National Health Council, National Assembly of National Voluntary Health and Social Welfare Organizations and United Way of America. Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations. Author, 1974.
6. United Way of America. Accounting & Financial Reporting, A Guide for United Way and Not-For-Profit Human Service Organizations. Alexandria, Va., Author, 1974.

APPENDIX 2(D)



LEGAL SERVICES CORPORATION
733 Fifteenth Street, N.W., Washington, D.C. 20005

Writer's Direct Telephone
(202) 272-4040

Dan J. Bradley
President

March 9, 1981

The Honorable M. Caldwell Butler
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Butler:

This is in further response to your inquiry at our oversight hearing regarding salary capabilities of legal services attorneys. I can assure you that legal services attorneys are highly trained and dedicated individuals, eminently capable of securing more prestigious positions and earning greater salaries in other legal sectors. While the Corporation does not maintain systematic data on the academic records of attorneys working in our local programs, or their career paths and salaries after leaving the program, we can provide you with some information which indicates the high quality professionals who are working in our local legal services programs.

Experience regarding vacant attorney positions varies around the country. For the most part, when a position for a staff attorney is advertised, a program will receive between fifty and two hundred applicants. A few programs in very large cities and highly desirable locations may receive a far greater number of applications. Some programs receive so many applications for positions, even without advertising, that the program must review resumes continually and inform the applicants that a position is not available. The program directors, of course, select the best candidates for each available position. At the very least, the denial of positions to well over 90% of all applicants indicates that attorneys of quality are being hired.

Although the Legal Services Corporation (LSC) does not maintain any records on the individual qualifications of staff attorneys in local programs, we do know that there are many graduates of the best law schools in the country, including law review editors, honors graduates and former federal judicial clerks, working for local programs. For example, the Legal Aid Society of Roanoke Valley recently hired five attorneys. One graduated sixth in his class at Washington and Lee and was Order of the Coif. Another was Phi Beta Kappa undergraduate at the University of Virginia, obtained a masters degree in psychology



LEGAL SERVICES CORPORATION

The Honorable M. Caldwell Butler
Page Two
March 9, 1981

there and then graduated high in her class at the University of Virginia Law School. A third also graduated from Virginia and was in private practice before joining the program. The fourth attorney graduated from Antioch, where she clerked for a D.C. Superior Court judge. The fifth new attorney achieved a 3.2 average on a 4.0 system at William and Mary Law School. The director of the program, Henry Woodward, was an Editor of the Yale Law Journal and is an adjunct professor at William and Mary Law School.

The director of the Legal Services Organization of Indiana, Norm Metzger, reported on two recent hires. A new staff attorney had been Phi Beta Kappa at the University of Denver and graduated in the top 15% of her class at George Washington University Law Center, where she was the school's representative in the regional moot court competition. Another new attorney graduated from the University of Indiana, and a third attorney graduated from Notre Dame Law School, where he was the student executive director of the Notre Dame Legal Aid and Defender Organization and supervised eight clinical divisions.

The project director of the Westchester Legal Services program in White Plains, New York, indicated that his program's eighteen staff attorneys graduated from the following undergraduate institutions: Brown, Vassar, City College, Berkeley, Harvard, Rutgers, Cornell, Skidmore, Wisconsin, Brooklyn College, SUNY-Oswego, Maryland, Smith, Virginia and Minnesota. Their law school degrees were from Syracuse, Cornell, St. Johns, NYU (4), Puget Sound, Rutgers, Hofstra (2), Buffalo, New York Law (2), Brooklyn, Memphis State, Virginia and Minnesota. Scattered among these degrees are law review, honors, and Phi Beta Kappa credentials.

Another view of the income potential of legal services staff attorneys can be obtained from data about the jobs that these attorneys secure when they leave legal services. For example, the director of litigation in the Indiana program who was a former Supreme Court Clerk, left the program to join a major Indianapolis firm as a partner. Another staff attorney, who had been on the law review at Indiana and Phi Beta Kappa as an undergraduate at the University of Chicago, recently left the program to join a middle sized Indianapolis firm at an increase of over \$10,000.



LEGAL SERVICES CORPORATION

The Honorable M. Caldwell Butler
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March 9, 1981

Similarly, in the Westchester program, two of the most recent departures have been to a relatively small midtown Manhattan firm and to the New York State Attorney General's office. Both attorneys obtained significant salary increases.

Many legal services attorneys move into positions of great importance in our society. For example, the last two directors of the Los Angeles program are now both judges of the Superior Court of the State of California.

I hope this information will be helpful to you and the other members of the Subcommittee. If I may be of any further assistance to you, please do not hesitate to contact me.

Sincerely,

Dan

Dan J. Bradley

cc: The Honorable Robert W. Kastenmeier
The Honorable Thomas F. Railsback

APPENDIX 2(E)



LEGAL SERVICES CORPORATION
733 Fifteenth Street, N.W., Washington, D.C. 20005

Writer's Direct Telephone
(202) 272-4040

Dan J. Bradley
President

March 9, 1981

The Honorable Robert W. Kastenmeier
Chairman, Subcommittee on Courts, Civil
Liberties & the Administration of Justice
Committee on the Judiciary
U.S. House of Representatives
2137 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

I am writing in further response to the questions you raised at the oversight hearing on the Legal Services Corporation (Corporation) held last week by your subcommittee. You asked several questions which required additional information to be provided as part of a complete response.

One of the questions you posed concerned what "normal" or "reasonable" access might be as opposed to the Corporation's current policy of "minimum" access.

The Corporation has not attempted to define a target for a national operating level beyond the "minimum access" level. The minimum access level, defined in 1976 as the equivalent of two attorneys for every 10,000 poor persons, was originally translated to mean that a program should be provided \$7.00 for every poor person living within the program's area of responsibility. In 1979, after three years without an inflation adjustment being made in this figure, the per poor person funding target was recalculated to include the annual cost of living adjustment to programs in that year. In fiscal year 1981, as a result, the minimum access funding level is \$8.23 per poor person. Because there were no adjustments between 1976 and 1979, and because the cost of living adjustment lagged behind inflation in 1979, 1980 and 1981, the actual current cost of providing the equivalent of two lawyers for every 10,000 poor persons is significantly higher than \$8.23.

Taking the current level as minimum access, however, it is clear that the emphasis must be on the "minimum." Phillip Stern, in Lawyers on Trial, suggests that there are fourteen attorneys for every 10,000 persons in the general population. Some of the



LEGAL SERVICES CORPORATION

The Honorable Robert W. Kastenmeier
Page Two
March 9, 1981

legal needs analyses done for the Corporation in local program areas have led us to estimate that there is an average of one significant legal problem per poor person per year. While many of the persons facing these problems might never seek help from legal services programs, the fact remains that we are only able to meet a small percentage of the total legal assistance needs of the nation's 30,000,000 low-income persons.

If Congress were to consider a reasonable plateau to pursue in an expanded attempt to bring equal justice under law to poor people, a next step might be four, five or six lawyers per ten thousand persons. Such an objective would clearly still fall short of meeting total needs. It would, however, be a critical step forward and would bring the United States far nearer fulfillment of our goal of equal justice for all.

The costs of attaining such a plateau are substantial, exceeding the capacity of public funds. Greater *pro bono* assistance by private lawyers is essential, and the Corporation is making every effort to increase this non-federal private commitment to equal justice.

You also asked the Corporation to make an estimate of the cost of legal services if provided solely in the private sector.

Unfortunately, I am not able to provide a very definitive statement of the cost that would be involved in providing our services if there were no legal services programs and private attorneys handled the cases for a fee. Many complex assumptions regarding fund distribution, cost and quality controls, priorities, local governance and the like would have to be factored in, as they are in our current programs.

I can, however, provide at least one comparative yardstick. In the Delivery Systems Study conducted by the Corporation during the past four years, several of the private bar models tested made use of "usual and customary" fee schedules for payment. By definition, these fee schedules represent the cost of performing legal services for the poor at standard private attorney rates. When the cost per hour of these services is compared to the cost per hour of services provided in standard legal services programs, the private attorney cost is more than twice that of the standard staff attorney program.



LEGAL SERVICES CORPORATION

The Honorable Robert W. Kastenmeier
Page Three
March 9, 1981

The Delivery Systems Study did suggest that private attorneys, working in conjunction with staff attorney programs, could provide supplemental services to poor persons at fees roughly comparable to the staff attorney programs. These fees, however, are reduced fees or involve substantial *pro bono* contributions from the private attorneys involved. The availability of such services is, however, limited. It is clear that such services would not be able to match the existing staff attorney programs either for volume of service or for cost effectiveness. The presence of the staff attorney element remains critical to cost effective, high volume, high quality legal services for poor people.

It is not possible to simply project the cost per hour comparison into the total funding of legal services. Many additional factors would have to be considered to make a valid estimate. But it does appear almost certain that turning solely to the private sector to provide the level of services provided at this time by legal services programs, and paying usual and customary fees for all such services, would at least double the cost of the program.

Finally, you asked for information about the effect of inflation on local programs and the number of offices that have been closed due to cost factors.

The Corporation does not maintain data on the number of offices closed each year and the reasons for the closings. Programs that open new offices with expansion funds may close existing offices in base areas already served. Programs may both open and close offices for reasons not directly related to inflation. For example, a program may open circuit riding offices to reach outlying populations and reduce the staff size in its existing offices. On the other hand, another program might consolidate several small offices so that economies of scale can take effect.

We have made a comparison of offices opened and closed as revealed by the program applications for refunding for FY 1980 and FY 1981. This analysis reveals that 22 programs (about 7%) have had to close at least one office during the year, for a total of 28 office closings.



LEGAL SERVICES CORPORATION

The Honorable Robert W. Kastenmeier
Page Four
March 9, 1981

I hope this information is helpful to you and the other members of the Subcommittee. If I may be of any further assistance, please do not hesitate to contact me.

Sincerely,

Dan

Dan J. Bradley

cc: The Honorable Thomas F. Railsback

APPENDIX 2(F)



LEGAL SERVICES CORPORATION
733 Fifteenth Street, N.W., Washington, D.C. 20005

Writer's Direct Telephone
(202) 272-4040

Dan J. Bradley
President

March 9, 1981

The Honorable Harold S. Sawyer
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Sawyer:

I am writing in further response to the questions you raised at the oversight hearing on the Legal Services Corporation ("Corporation") held last week by the House Judiciary Subcommittee on Courts, Civil Liberties and the Administration of Justice. You asked whether the legal needs of moderate-income persons -- persons with gross incomes in the \$10,000 to \$20,000 range -- are being met in about the same proportion as the needs of low-income persons.

Unfortunately, the Corporation has very little data or information about the use of lawyers by persons of moderate incomes. Since the Corporation's statutory charge is to provide legal services to persons with low incomes, it does not collect data about either the legal needs of moderate-income persons or their ability to secure legal assistance.

I can, however, share with you some useful information we have about how the legal needs of poor people and their use of lawyers differ from those of persons with greater incomes.

The Corporation's Delivery Systems Study found that private attorneys who take some legal services cases for the poor generally handle the types of cases with which they have some experience. Because the poor have legal problems which are unique to their financial status -- problems in the areas of AFDC and other public assistance, food stamps, Supplemental Security Income, subsidized housing, Medicare and Medicaid -- persons of moderate or greater incomes do not experience these same problems and, therefore, these problems are not reflected in the cases handled by most private attorneys.



LEGAL SERVICES CORPORATION

The Honorable Harold S. Sawyer
 March 9, 1981
 Page Two

Similarly, the class of general problems are often different in nature when the client is poor -- problems in the areas of unemployment compensation, unfair sales practices, landlord-tenant rights and responsibilities, education, job discrimination, wage claims and spousal abuse. Often a legal services program is the only source of legal counsel for poor people with problems in these areas. This is not true, however, for persons of moderate and higher incomes; proportionately there are a far greater number of lawyers with relevant expertise to handle their legal problems.

The American Bar Association Special Committee to Survey Legal Needs found that both the lack of information about when a lawyer might be helpful and apprehension about approaching a lawyer are significant access barriers to seeking legal assistance.

The available data from the American Bar Foundation's report on The Legal Needs of the Public suggests that the discretionary income of persons who use lawyers is significantly higher than the discretionary income of persons who do not use lawyers. (Discretionary income for these purposes is defined as family income above 125 percent of the Office of Management and Budget (OMB) poverty line.) The mean income of lawyers users was \$9,855, while the mean for non-users was \$8,073. The median figure for lawyers users was \$8,092, however, while the median for non-users was only \$5,894. This pair of differences between the means and the medians for users and non-users indicates an even greater effect from the presence of discretionary income. Families at lower income levels appear, from this data, to be much less likely to resort to an attorney. This result occurs despite the presence of free legal services. In addition, the data show that multiple use of attorneys is also significantly higher among higher income families.

Despite the absence of more refined data, it can be concluded that the lower the level of discretionary income, the lower the utilization of attorneys. As discretionary income decreases, the use of lawyers declines. When there is no discretionary

APPENDIX 2(G)



LEGAL SERVICES CORPORATION
 733 Fifteenth Street, N.W., Washington, D.C. 20005

Writer's Direct Telephone
 (202) 272-4040

Dan J. Bradley
 President

March 9, 1981

The Honorable Harold S. Sawyer
 U.S. House of Representatives
 Washington, D.C. 20515

Dear Congressman Sawyer:

I am writing in further response to the questions you raised at the oversight hearing on the Legal Services Corporation held last week by the House Judiciary Subcommittee on Courts, Civil Liberties and the Administration of Justice. You requested some indication of the number of low-income persons eligible for legal services but nevertheless turned away for lack of resources.

The Corporation does not currently require its grantees to keep statistics or information about the number of persons eligible for free legal assistance who are, unfortunately, turned away because the grantee does not have sufficient resources to serve its entire eligible population. Therefore, the Corporation is unable to provide specific national data in answer to your question.

However, a number of our local programs do collect this information in various forms for their own use. The following examples provide some insight as to the demand for services that currently goes unmet:

1. New Haven Legal Assistance Association, New Haven, Connecticut. The New Haven Legal Assistance Association program keeps records of persons financially eligible for assistance who are rejected for legal services. In 1980, the program served 2,000 eligible low-income persons, but approximately 8,000 other eligible low-income persons were rejected or referred elsewhere. In other words, New Haven Legal Assistance is able to serve only one in every five persons requesting assistance.

2. Legal Aid Society of Central Texas, Austin, Texas. Due to the great demand for legal representation, the Legal Aid Society of Central Texas had to severely limit the types of legal problems for which it will provide assistance. In the Domestic Relations Unit, there is a three-month waiting list for appointments, and appointments are made only in very limited circumstances; even then the program accepts no domestic relations cases unless children are involved, and handles no paternity cases.



LEGAL SERVICES CORPORATION

The Honorable Harold S. Sawyer
March 9, 1981
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3. Community Legal Aid Society, Inc., Wilmington, Delaware.
The Community Legal Aid Society was forced to close intake for its Family Law Unit for four months in 1980 due to the high number of backlogged cases. Throughout this four month period, only emergencies were accepted by the Family Law Unit.

4. Camden Regional Legal Services, Camden, New Jersey.
For varying periods of time during 1980, Camden Regional Legal Services had to close intake for several program units -- including housing and domestic relations -- due to excessive case backlogs and a high demand for services that could not be met.

5. Bexar County Legal Aid Association, San Antonio, Texas.
The Bexar County Legal Aid Association has established its financial eligibility standard at 80 percent of the maximum allowable under the Corporation's regulations. (Under the LSC regulations, the maximum is 125 percent of the Office of Management and Budget's (OMB) established poverty level.)

Despite this lower eligibility limit, there is a waiting list of one to three weeks for a client to be interviewed. The program's domestic relations unit is making appointments 60 days in advance. In 1980, the program had to reject 48 percent of all applicants; 90 percent of the rejected applicants were eligible for services at the program's own lower eligibility limit.

I hope these examples will provide you and the Subcommittee with sufficient information regarding the unmet demand by persons eligible for free legal assistance. If I can be of any further assistance, please do not hesitate to contact me.

Sincerely,

Dan

Dan J. Bradley

cc: Chairman Robert W. Kastenmeier
The Honorable Thomas F. Railsback



LEGAL SERVICES CORPORATION

The Honorable Harold S. Sawyer
March 9, 1981
Page Three

income, which is the case for all legal services clients (by definition), the only services which a poor person has access to are those of legal services programs.

I hope this information will be helpful to you and the other members of the Subcommittee. If I may be of any further assistance, please do not hesitate to contact me.

Sincerely,

Dan

Dan J. Bradley

cc: The Honorable Robert W. Kastenmeier
The Honorable Thomas F. Railsback

END