Legal Services Corporation: Governance and Accountability Practices Need to Be Modernized and Strengthened

GAO-07-993 August 15, 2007

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Summary

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

Although LSC has stronger federal accountability requirements than many nonprofit corporations, it is subject to governance and accountability requirements that are weaker than those of independent federal agencies and U.S. government corporations. Congress issued LSC's federal charter over 30 years ago. Established with governance and accountability requirements as they existed at the time, LSC has not kept up with evolving reforms aimed at strengthening internal control over an organization's financial reporting process and systems. Rigorous controls are important for the heavily federally funded LSC. During fiscal year 2007, LSC is responsible for the safeguarding and stewardship of $348.6 million of taxpayer dollars. Although no single set of practices exists for both private and public entities, current accepted practices of federal agencies, government corporations, and nonprofit corporations offer models for strengthening LSC's governance and accountability, including effective board oversight of management; its performance; and its use of federal funds and resources. The board members demonstrated active involvement in LSC through their regular board meeting attendance and participation in LSC oversight. Although LSC's Board of Directors was established with provisions in law that may have supported effective operation over 30 years ago, its practices fall short of modern board practices. The LSC board generally provides each new member an informal orientation to LSC and the board, but it does not have consistent, formal orientation and ongoing training with updates on new developments in governance and accountability standards and practice. The current board has four committees, but none are specifically targeted at providing critical audit, ethics, or compensation functions, which are important governance mechanisms commonly used in corporate governance structures. Because it has not taken advantage of opportunities to incorporate such practices, LSC's Board of Directors is at risk of not being able to fulfill its role of effective governance and oversight. A properly implemented governance and accountability structure may have prevented recent incidents of compensation rates in excess of statutory caps, questionable expenditures, and potential conflicts of interest. LSC also has not kept up with current management practices. Of particular importance are key processes in risk assessment, internal control, and financial reporting. Management has not formally assessed the risks to the safeguarding of its assets and maintaining the effectiveness and efficiency of its operation, nor has it implemented internal controls or other risk mitigation policies. LSC is also at increased risk that conflicts of interest will occur and not be identified because senior management has not established comprehensive policies or procedures regarding ethical issues that are aimed at identifying potential conflicts and taking appropriate actions to prevent them. Finally, management has not performed its own assessment or analysis of accounting standards to determine the most appropriate standards for LSC to follow.

Recommendations

Our recommendations from this work are listed below with a Contact for more information. Status will change from "In process" to "Open," "Closed - implemented," or "Closed - not implemented" based on our follow up work.

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Matters for Congressional Consideration

Recommendation: Since the LSC Act was enacted in 1974 and last comprehensively amended and reauthorized in 1977, new laws governing federal agencies, U.S. government corporations, and public companies have been enacted to strengthen governance and accountability requirements. Therefore, Congress may wish to consider whether LSC could benefit from additional legislatively mandated governance and accountability requirements, such as financial reporting and internal control requirements, modeled after what has worked successfully at federal agencies or U.S. government corporations. There are different options available to Congress for such a mandate. Congress may wish to maintain LSC's current organizational structure as a federally chartered and federally funded, private, nonmembership, and tax-exempt D.C. nonprofit corporation and enact permanent legislation to require LSC to implement additional governance and accountability requirements.

Status: Open

Comments: In recent years, we have had conversations with congressional staff regarding the need for Congressional action on this matter. However, as of December 2010, while still considering action in this area, no specific action has been taken as yet.

Recommendation: Since the LSC Act was enacted in 1974 and last comprehensively amended and reauthorized in 1977, new laws governing federal agencies, U.S. government corporations, and public companies have been enacted to strengthen governance and accountability requirements. Therefore, Congress may wish to consider whether LSC could benefit from additional legislatively mandated governance and accountability requirements, such as financial reporting and internal control requirements, modeled after what has worked successfully at federal agencies or U.S. government corporations. There are different options available to Congress for such a mandate. Congress may wish to enact legislation to convert LSC to a federal entity (such as a U.S. government corporation subject to the Government Corporation Control Act) or an independent federal agency that is required to follow the same laws and regulations as executive branch agencies. In the statute establishing LSC as a federal entity, Congress could specifically exempt LSC from certain requirements that would otherwise apply to that type of federal entity in order to further special policy considerations particular to LSC.

Status: Open

Comments: In recent years we have had conversation with Congressional staff regarding this matter. However, as of December 2010, while action is under consideration, no specific action has been taken as yet.

Recommendations for Executive Action

Recommendation: In order to improve and modernize the governance processes and structure of LSC, the LSC Board of Directors should establish and implement a comprehensive orientation program for new board members to include key topics such as fiduciary duties, Internal Revenue Service requirements, and interpretation of the financial statements.

Agency Affected: Legal Services Corporation

Status: Closed - implemented

Comments: In a 2007 review of Legal Services Corporation (LSC) governance and accountability, GAO found that new LSC board member orientation did not include key information on oversight and fiduciary responsibilities, including Washington, D.C. law governing nonprofits; the Internal Revenue Service (IRS) regulatory requirements for nonprofit organizations; interpreting LSC's financial statements; managing sensitive documents; FOIA requirements; or travel expenditure limitations. New board member training is a basic tool used by well-functioning boards. Further, without comprehensive orientation, LSC board members may not be adequately prepared to effectively fulfill their oversight and governance responsibilities. GAO recommended that the Board establish and implement a comprehensive orientation program for new board members to include key topics such as fiduciary duties, IRS requirements, and interpretation of the financial statements. Over the course of 2008 and 2009, LSC's Governance and Performance Review Committee developed a comprehensive curriculum for new member orientation. The orientation topics address the following: History of LSC; LSC Structure and Staff; Board Roles and Responsibilities; Board Meetings; Budgets; Regulatory Process; Oversight; Government Accountability

Office Reports; Litigation Report; Job Descriptions; Recent Activities of LSC, and other topics, such as LSC IRS 990 Form. Orientation materials included the IRS Form 990 Return of Organization Exempt from Income Tax; a Budget and Administration presentation by the Chief Administration Officer, which included an overview of the LSC Strategic Plan; and an overview of the Congressional Appropriations Process, LSC Budget Cycle, and LSC financial information, such as income and expenditures. Other orientation materials included the Guidelines for Adoption, Review and Modification of the Consolidated Operating Budget of the Legal Services Corporation, Management's Recommendations for LSC's FY 2011 Budget Request, and an in-depth outline for orientation of Board Nominees on Administrative Operations. New board member orientation sessions in December 2009 and January and November 2010, provided members an in-person orientation session by the President of LSC, the Corporate Secretary, the Director of Government Relations and Public Affairs, the Chief Administrative Officer, the Comptroller/Treasurer, the Vice President for Programs and Compliance, and the Office of Inspector General. Based on the establishment and implementation of a comprehensive Board orientation, LSC's governance structure should be enhanced through increased board knowledge of current, relevant governance and accountability practices. As a result, the Board will be better able to address issues as they arise and more effectively govern LSC.

Recommendation: In order to improve and modernize the governance processes and structure of LSC, the LSC Board of Directors should develop a plan for providing a regular training program for board members that includes providing updates or changes in LSC's operating environment and relevant governance and accountability practices.

Agency Affected: Legal Services Corporation

Status: Closed - implemented

Comments: In a 2007 review of Legal Services Corporation (LSC) governance and accountability, GAO found that LSC's board did not have an ongoing (e.g., annual) training program for its board members. In general, it is a good management practice for such governing boards to stay current with changes in governance practices, its regulatory environment, and key management practices and requirements in such areas as risk assessment and mitigation, internal controls, and financial reporting. One way to achieve this objective is through requiring board members to receive annual training on current best practices in these areas. GAO recommended that LSC develop a plan for providing periodic training to board members that included providing updates or changes in LSC's operating environment and relevant governance and accountability practices. In March 2010, LSC issued an LSC Board of Directors Training Program document. As a result, if the board training is implemented as planned in the Board of Directors Training Program, LSC's governance structure will be enhanced through increased board knowledge of current, relevant governance and accountability practices.

Recommendation: In order to improve and modernize the governance processes and structure of LSC, the LSC Board of Directors should establish an audit committee function to provide oversight to LSC's financial reporting and audit processes either through creating a separate audit committee or by rewriting the charter of its finance committee.

Agency Affected: Legal Services Corporation

Status: Closed - implemented

Comments: As part of its 2007 review of the Legal Services Corporation (LSC), GAO recommended that the LSC establish an audit committee function to provide oversight to LSC's financial reporting and audit processes either through creating a separate audit committee or by rewriting the charter of its finance committee. On March 24, 2008, the LSC Board of Directors established an audit committee and adopted an audit committee charter. Under this charter, the audit committee is charged with assisting the Board in fulfilling its responsibility to ensure that the Corporation's assets are properly safeguarded; to oversee the quality and integrity of the Corporation's accounting, auditing, and reporting practices. LSC's actions to establish an audit committee, if fully and effectively implemented, should enable LSC to more effectively oversee its financial reporting and audit processes.

Recommendation: In order to improve and modernize the governance processes and structure of LSC, the LSC Board of Directors should establish a compensation committee function to oversee compensation matters involving LSC officers and overall compensation structure either through creating a separate compensation committee or by rewriting the charter of its annual performance review committee.

Agency Affected: Legal Services Corporation

Status: Closed - implemented

Comments: In our 2007 review of Legal Services Corporation (LSC) governance and accountability, GAO found that LSC's board does not have a compensation committee to oversee LSC's overall compensation structure, including the compensation provided to LSC's officers. Such a compensation committee is an accepted practice for nonprofit corporations and required for public companies listed on the New York Stock Exchange. GAO recommended that the LSC establish a function to oversee its overall compensation structure, including compensation matters involving LSC officers, either through creating a separate compensation committee or by rewriting the charter of its performance review committee to include such responsibilities. On October 31, 2009, the Governance Performance Review Committee passed a resolution augmenting its charter to provide for annually reviewing LSC's compensation plan and LSC officers compensation. If these augmented committee responsibilities are fully and effectively implemented, LSC's governance structure will be enhanced through increased oversight of compensation across LSC.

Recommendation: In order to improve and modernize the governance processes and structure of LSC, the LSC Board of Directors should establish charters for the Board of Directors and all existing and any newly developed committees to clearly establish committees' purposes, duties, and responsibilities.

Agency Affected: Legal Services Corporation

Status: Closed - implemented

Comments: In 2007, GAO reported the Legal Services Corporation (LSC) board and its committees did not have charters that established their purpose and responsibilities. A charter defines committee membership, and members' oversight duties and responsibilities. GAO found that this condition resulted from the LSC not keeping up with current practices for non profit corporations. LSC issued a board resolution in 1995 that provided descriptions of the committees, but the resolution does not contain the elements of a charter and the resolution has not been updated since it was issued in 1995 for three of the four committees. The fourth committee was established in 2003. GAO recommended that the LSC establish charters for its newly developed committees to clearly establish their purposes, duties and responsibilities. In 2008, the LSC Board established charters for its Audit, Finance, Operations and Regulations, Provision for the Delivery of Legal Services, and Governance and Performance Review Committees. With the establishment of these charters describing committee duties and responsibilities, LSC has a foundation for establishing effective accountability and has reduced the risk that LSC committees and their members are performing duties beyond the scope of their respective charters.

Recommendation: In order to improve and modernize the governance processes and structure of LSC, the LSC Board of Directors should implement a periodic self-assessment of the board's, the committees', and each individual member's performance for purposes of evaluating whether improvements can be made to the board's structure and processes.

Agency Affected: Legal Services Corporation

Status: Closed - implemented

Comments: In a 2007 review of Legal Services Corporation (LSC) governance and accountability, GAO found that the LSC board did not assess the performance of the overall board, its committees, or the individual board members. Such periodic assessments assist the board in determining whether it is meeting its intended goals and fulfilling its duties, and enables the board to identify areas for improvement in the board's operating procedures, its committee structure, and its governance practices. Board assessments are a common practice for nonprofit corporation boards and a NYSE listing requirement for audit committees of public companies. An assessment can include (1) an overall self-assessment of the entire board, (2) an assessment of the separate board committees, (3) individual board member assessments, or (4) all three. GAO recommended that LSC's Board of Directors implement periodic self-assessments of the board's, the committee's, and individual member's performance for purposes of evaluating whether improvements can be made to the board's structure and processes. In response to our recommendation, LSC implemented processes for Board, committee, and individual board member assessments. LSC's Board approved the process on April 7, 2010. According to LSC documentation, the Board Self-Evaluation is designed to give the Board an opportunity to assess its group performance in meeting annual goals and to set new goals for the upcoming program year and to serve as the basis for a planning discussion at the annual meeting of the Board. The committee self-evaluation is designed to give each committee's members an annual opportunity to provide feedback to committee chairs and for all committee members to assess the performance of the committee against a common set of protocols. According to LSC management, the first committee self-evaluation was conducted in 2010 and provided feedback on areas of strengths, areas needing improvement, and committee goals for the year for each committee to use during a January discussion. Board members' individual self evaluations were implemented in 2009. By implementing such comprehensive board assessments, committee assessments and individual board member assessments, LSC has enhanced its governance structure. Specifically, by providing regular, ongoing feedback and awareness of areas needing improvement, the Board will be better able to address issues as they arise and, thus, more effectively govern LSC.

Recommendation: In order to improve and modernize the governance processes and structure of LSC, the LSC Board of Directors should develop and implement procedures to periodically evaluate key management processes, including at a minimum, processes for risk assessment and mitigation, internal control, and financial reporting.

Agency Affected: Legal Services Corporation

Status: Closed - implemented

Comments: In a 2007 review of Legal Services Corporation (LSC) governance and accountability, GAO reported that LSC management relies on a cycle memorandum prepared by LSC's external auditor as management's assessment of internal controls. The cycle memorandum contained process descriptions but did not identify internal controls, their objectives, or management's assertions (completeness, rights and obligations, valuation, existence, and presentation and disclosure) that the controls are intended to address. Instead, LSC's management conducted ongoing, informal assessments of selected financial processes on an ad hoc basis. However, these management assessments were not utilized as part of a comprehensive internal control evaluation. Without comprehensive internal control assessment and monitoring, LSC is at risk that it will not prevent or promptly detect any internal control failures, including unauthorized or improper use of federal funds or violations of laws or regulations in its operations. GAO recommended that the Board develop and implement procedures to periodically evaluate key management processes, including at a minimum, processes for risk assessment and mitigation, internal control, and financial reporting. In 2010, LSC developed and implemented new procedures by first identifying its six major management processes and priorities for evaluation of the major processes. Specifically, LSC in 2010 evaluated (1) grant awards and (2) internal financial controls and plans to evaluated in 2011, accuracy of grantee data. For example, LSC's Office of Information Management developed a checklist for Office of Program Performance to verify the accuracy of information included in grant award letters. In July 2010, LSC management evaluated the grant award process and briefed the LSC Audit Committee on September 9, 2010 on the results of the identification of several key internal controls in the grant awards process. For example, LSC documented internal controls related to grantee payments. In addition, in September 2010, LSC also hired an independent risk assessment consultant to perform an assessment of LSC's internal controls within the grant-making process. LSC's actions demonstrate that the Board has developed and implemented procedures to periodically evaluate key management processes. These new procedures help strengthen LSC's internal control environment and reduces the risk that internal control failures, including unauthorized or improper use of federal funds or violations of laws or regulations, will occur and not be detected.

Recommendation: In order to improve and modernize the governance processes and structure of LSC, the LSC Board of Directors should establish a shorter time frame (e.g., 60 days) for issuing LSC's audited financial statements.

Agency Affected: Legal Services Corporation

Status: Closed - implemented

Comments: In its 2007 review of Legal Services Corporation (LSC) governance and accountability, GAO found that for the previous 5 years, LSC issued its audited financial statements in March or later, which is 6 months or more after its year-end of September 30th. GAO recommended that LSC establish a shorter time frame (e.g., 60 days) for issuing its audited financial statements. LSC's Board of Directors instructed LSC's Office of Inspector General (OIG) to deliver audited financial statements for the year ending September 30, 2007 earlier than the financial statements had been in previous years. Subsequently, the audited financial statements for the year ending September 30, 2007 were issued on January 7, 2008 and the September 30, 2008 audited financial statements were issued on January 28, 2009. Further, to ensure the timeliness on the issuance of the financial statements for the year ending September 30, 2009, LSC established a completion date of December 15, 2009 for LSC's auditor. In addition, both the OIG and LSC's Office of Financial & Administrative Services (OFAS) have committed to monitoring the progress of the financial statements and ensuring that the process is completed on time. As a result of LSC's guidance requiring accelerated completion dates and oversight, LSC reduced the time frame for issuing its annual audited financial statements and thereby helped to increase the relevancy of the financial information.

Recommendation: In order to improve and modernize key management processes at LSC, the president and executive committee should conduct and document a risk assessment and implement a corresponding risk management program as part of a comprehensive evaluation of internal control.

Agency Affected: Legal Services Corporation

Status: Closed - implemented

Comments: In its 2007 review of the Legal Services Corporation (LSC), GAO found that Management had not established risk mitigation policies. According to the Standards for Internal Control in the Federal Government, internal control should provide for an assessment of the risks the agency faces from both external and internal sources. GAO recommended that LSC develop and implement a risk management program as part of a comprehensive evaluation of internal control. Subsequently, on January 31, 2009, LSC implemented a risk assessment and risk management plan in a document entitled "LSC Risk Management Program". Our review of LSC's Risk Management Plan showed it included appropriate risk management roles and responsibilities for both the LSC audit committee and LSC executives. Further, LSC held an internal control risk assessment session with its board on December 11, 2008. With LSC's actions to establish a comprehensive internal control risk assessment program, LSC should have greater assurance that it has appropriate, risk-based internal controls in place when its internal control reviews are implemented.

Recommendation: In order to improve and modernize key management processes at LSC, the president and executive committee should, with the board's oversight, evaluate and document relevant requirements of the Sarbanes-Oxley Act of 2002 and practices of the New York Stock Exchange and the American Bar Association that are used to establish a comprehensive code of conduct, including ethics and conflict-of-interest policies and procedures for employees and officers of the corporation.

Agency Affected: Legal Services Corporation

Status: Closed - implemented

Comments: In an August 2007 review of Legal Services Corporation (LSC) governance and accountability, GAO found that LSC did not have policies and procedures establishing a code of conduct for its employees concerning conflict-of-interest or ethics issues. Lacking such policies and procedures, the LSC Office of the Inspector General (OIG) found several instances of non-ethical conduct including using LSC funds to pay for non-LSC related travel expenses for its President. The LSC OIG also reported that LSC had hired special councils responsible for providing management with advice on policy who were also employees of organizations that receive LSC grant money, causing potential conflicts of interest. GAO recommended that LSC, with the oversight of LSC's board, evaluate ethics and conflict-of-interest requirements of the Sarbanes-Oxley Act of 2002 and related policies and procedures of the New York Stock Exchange (NYSE) and American Bar Association (ABA) to establish a comprehensive code of conduct for LSC employees, including policies and procedures for LSC's corporate officers. In response, LSC formed a task force to study corporate compliance programs that considered Sarbanes-Oxley requirements as well as the practices of NYSE and the ABA in the formation of a proposed code of conduct policy and procedures for the agency and presented a proposal to LSC's Operations and Regulations Committee. After further consideration and refinements by LSC's Operations and Regulations Committee in October 2007 and January 2008, the LSC board adopted a code of conduct for LSC at its March 2008 Board Meeting. LSC's final policies and procedures, the Code of Ethics and Conduct, includes a conflict-of-interest policy and applies to all LSC Directors, officers and employees. Based on the actions taken to date by LSC, the agency now has greater assurance that its personnel will be aware of their responsibilities in the area of ethics and conflicts of interest and that policies and procedures are in place to identify and avoid future ethics violations and conflicts of interest.

Recommendation: In order to improve and modernize key management processes at LSC, the president and executive committee should establish a comprehensive and effective comprehensive continuity of operations program, including conducting a simulation to test the established program.

Agency Affected: Legal Services Corporation

Status: Closed - implemented

Comments: In a fiscal year 2007 review of the Legal Services Corporation (LSC), GAO found that although LSC does have a Comprehensive Continuity Of Operations Plan (COOP), the plan was not complete or comprehensive. For example, LSC's COOP did not provide information on essential functions for each office. In addition, GAO found that LSC had not conducted a comprehensive assessment to identify risks or identify acceptable levels of risk associated with LSC's current COOP. GAO recommended that LSC develop a comprehensive COOP and risk assessment and management program. Subsequently, in March 2008, LSC issued a two volume Continuity of Operations Plan. LSC's COOP consists of the Emergency Response Plan and the Continuity of Operations Plan. Also, in January of 2009, LSC established a Risk Management Program which considered the risk posed by threats to continuity of operations. The LSC COOP primarily relies on LSC personnel relocating from their headquarters offices to their residences to continue operations through telework. Such action is identified as a desired practice in GAO's CONTINUITY OF OPERATIONS: Selected Agencies Could Improve Planning for Use of Alternate Facilities and Telework during Disruptions (GAO 06-713). Further LSC's COOP substantially complies with the ten requirements for effective federal COOP's as defined by the Federal Emergency Management Agency's FPC 65. In addition, during September 2008, LSC successfully tested the telephone trees identified in LSC's COOP. As a result of LSC's actions to implement a comprehensive COOP and associated risk management program, it is now better able to ensure its ability to continue operations in the event of a catastrophic event.

Recommendation: In order to improve and modernize key management processes at LSC, the president and executive committee should conduct an evaluation to determine whether the Government Accounting Standards Board should be adopted as a financial reporting standard for LSC's annual financial statements.

Agency Affected: Legal Services Corporation

Status: Closed - implemented

Comments: In a 2007 review of Legal Services Corporation (LSC) governance and accountability (GAO-07-993), GAO found that LSC's management had not conducted an assessment of accounting standards--those promulgated by the Financial Accounting Standards Board (FASB), Government Accounting Standards Board (GASB), or Federal Accounting Standards Advisory Board--most applicable to LSC operations. GAO recommended that LSC conduct an evaluation to determine which set of standards should be adopted for preparing LSC's annual financial statements. Subsequently, in October of 2007, an LSC management assessment concluded LSC should use GASB as the financial reporting standard for LSC's financial statements. An LSC IG review of LSC's management's assessment concluded it provided a full and complete analysis to determine which accounting standards should be used by LSC. Also, in October 2007, LSC Management presented the results of their evaluation to the LSC Board of Director's Finance Committee. The Finance Committee agreed with Management's recommendation and presented their recommendation in an open session of the Board of Directors. LSC's Board of Directors agreed with the assessments of both LSC management and the finance committee to use GASB as the financial reporting standard for LSC's annual financial statements. As a result of LSC's assessments, LSC now has a more informed basis for the financial reporting standards it will use to prepare its annual financial statements.
