

TRANSCRIPT OF PROCEEDINGS

LEGAL SERVICES CORPORATION

AUDIT AND APPROPRIATIONS COMMITTEE MEETING

Pages: 1 through 95

Place: Washington, D.C.

Date: October 25, 1985

Acme Reporting Company

Official Reporters
1220 L Street, N.W.
Washington, D. C. 20005
(202) 628-4888

1 LEGAL SERVICES CORPORATION

2

3 Audit and Appropriations Committee Meeting

4

5

Friday,
October 25, 1985

6

7

Lewis Room
Capitol Holiday Inn
550 C Street, SW
Washington, D.C.

8

9

The committee met, pursuant to notice,

10 at 2:00 p.m.

11

PRESENT:

12

PEPE MENDEZ, CHAIRMAN

13

MICHAEL WALLACE, ESQ.

14

W. CLARK DURANT, III, ESQ.

15

LEA ANNE BERNSTEIN, ESQ.

16

HORTENCIA BENAVIDEZ

17

LORAIN MILLER

18

19

20

21

22

23

24

25

P R O C E E D I N G S1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

CHAIRMAN MENDEZ: All right. The Audit and Appropriations Committee will come to order.

The Chair will entertain a motion to adopt the agenda.

MR. WALLACE: So moved.

CHAIRMAN MENDEZ: All in favor?

(Chorus of Ayes)

CHAIRMAN MENDEZ: Okay. Looks pretty good.

MR. WALLACE: Simple agenda.

CHAIRMAN MENDEZ: All right. The purpose, as stated in the agenda, is the revision of the Audit and Accounting Guide.

Pursuant to direction, the staff has met with Mr. Simpson and before we touch base on anything else, I would invite Mr. Thimell to come forward with regard to his memorandum. I've had some conversations previously off the record. I think that there are some matters that we can take very quickly.

MR. THIMELL: Joel Thimell, Acting Staff Coordinator, Audit and Appropriations Committee.

The staff met with Mr. Simpson on Wednesday, for quite some time, to gain his comments on behalf of the Project Advisory Group concerning the proposed audit guide. In addition, he submitted three rather extensive memoranda outlining

1 these positions. We reviewed these comments very carefully,
2 and have a number of their suggestions, which we would recommend
3 that you adopt into the revised audit guide.

4 I trust every one has a copy of the gray version
5 in front of you. That version is exactly the same version --

6 CHAIRMAN MENDEZ: Just a second. Do all members
7 of the public have a copy?

8 MS. BERNSTEIN: I don't want to interrupt you,
9 but could you explain to me what the distinction is between
10 this and the orange. I'm having to color code my questions.

11 MR. THIMELL: The orange guide was mailed to you
12 approximately ten days prior to the Guilford meeting, and
13 was revised between the time it was mailed and the meeting,
14 and it has been replaced, superseded by the gray version.

15 MS. BERNSTEIN: Okay. That's the difference.

16 MR. THIMELL: Okay. The gray version that you
17 have now is, in fact, the same version which was distributed
18 and discussed at the Gilford meeting.

19 I'd just like to go very quickly through these
20 suggestions and give a brief explanation and recommend that
21 they be adopted, if that's satisfactory to the committee.

22 On section 1-7 on page 6, it was suggested that
23 the sentence in the middle of the first paragraph, defining
24 control for purposes of inter-related organization, should
25 be rewritten slightly for purposes of clarity, and, so, we've

1 agreed to delete the word "operating" near the end of that
2 sentence in front of "policies" to parallel the previous
3 clause in (a) which speaks of management and policies and
4 clause (b) reflects management or policies as well.
5 And, we have, in fact, put in a semi-colon following the
6 first clause to clarify that, where (a) ends and (b) begins,
7 and that, in fact, all of the language following (b), including
8 to the extent that an arms'-length transaction may not be
9 achieved refers solely to (b) and not to (a).

10 MR. WALLACE: Where's the semi-colon go?

11 MR. THIMELL: The semi-colon goes after "policies",
12 "(a) determine the direction of management and policies;
13 or (b)", and we have deleted that "influence" -- I mean that,
14 too, and "(b) influence the management or policies of another
15 organization to the extent that an arms'-length transaction
16 may not be achieved."

17 The point that's being made is simply that under
18 (a) you were outright determining the direction of management
19 and policies, and under (b) there's enough influence being
20 exerted that arms'-length transactions are no longer possible.

21 In that same section, under factor B, it was suggested
22 that the last line there, "Resources that are provided by
23 another organization ...", should be "resources that are
24 provided by controlling organizations ..." to clarify in
25 that factor which funds that we're talking about and which

1 organizations we're talking about. We agree with that.

2 We also agreed that there should be an exception
3 for bona fide bar associations, that we don't need to apply
4 the combined financial reporting requirements to bar associations
5 merely by the fact that they may appoint the board to the
6 local program, and they may have some sort of pro bono program
7 relationship with them, and it would be suggested that following
8 the paragraph on page 7, that begins, "These facts and all
9 relevant facts must be carefully weighed in each situation
10 to determine whether control exists.", that there is a basis
11 for reasonable doubt whether the control exists; that basis
12 should be disclosed and the sentence be added to the effect
13 that this section should not be interpreted so as to apply
14 to bona fide bar associations which do not directly provide
15 legal services.

16 MS. BERNSTEIN: Is that the exact wording of that
17 sentence or is that your wording?

18 MR. THIMELL: Well, I think that wording could
19 be perfected.

20 MS. BERNSTEIN: Well, I'm not happy with the wording
21 that you just stated. So, if --

22 MR. THIMELL: No. That's the thought, as opposed
23 to the precise language of the recommendation. I'm open
24 to --

25 MS. BERNSTEIN: What -- as I understood when you

1 were explaining it, we were talking about a pro bono situation.
2 I think if a bar association gets through need for service
3 or referral, you know, where there's a remunitive problem,
4 that whether the bar association now would get the problem.

5 MR. THIMELL: Okay.

6 MS. BERNSTEIN: So, I would make pro bono the only
7 exception.

8 MR. THIMELL: Yeah. I think, I think what this
9 says is that a bar association that does not directly provide
10 those services, their members may be providing services through
11 another separate program.

12 CHAIRMAN MENDEZ: I think, it's --

13 MS. BERNSTEIN: Okay. Maybe I'm not understanding
14 what you're saying.

15 MR. THIMELL: In other words, we're trying to make
16 a distinction between the bar association's finances and
17 that of its members, which may be participating in an
18 adjudicare arrangement with the program through an organized
19 bar umbrella. Maybe that's a bad distinction, but I think
20 the question is whose statement would or would not be
21 combined.

22 Are we talking about combining --

23 MS. BERNSTEIN: Individual attorneys' income statement
24 or the bar association's?

25 MR. THIMELL: That's correct.

1 MS. BERNSTEIN: Which is strictly the auspices
2 under which people are --

3 MR. THIMELL: Right.

4 MS. BERNSTEIN: Okay.

5 MR. THIMELL: That is the intent. Now, --

6 MS. BERNSTEIN: Okay.

7 CHAIRMAN MENDEZ: Mr. Simpson, that's agreeable?

8 MR. SIMPSON: Yes, that's agreeable.

9 MR. THIMELL: I don't think it's perfect language,
10 but the language would be -- let's see. This section should
11 not be construed to apply to bona fide bar associations which
12 do not directly provide legal services.

13 CHAIRMAN MENDEZ: Is there any comment concerning
14 that amendment?

15 MR. THIMELL: At the end of the first paragraph
16 following all of those factors, there's an additional sentence
17 there.

18 MR. SIMPSON: I think that's it.

19 CHAIRMAN MENDEZ: Okay.

20 MR. SIMPSON: I had some different language, but
21 that's okay.

22 MR. THIMELL: The last item in 1-7, which was brought
23 to our attention, which we are also agreeing should be changed,
24 in the very last paragraph of 1-7, that sentence "Funds held
25 by an organization which controls, is controlled by or subject

1 to common control, of a recipient ...", and the point was
2 made that probably should be with rather than of and a comma
3 following with.

4 So, it should be, "Funds held by an organization
5 which controls, is controlled by or is subject to common
6 control with, a recipient or sub-recipient,"are subject to
7 the same restrictions."

8 CHAIRMAN MENDEZ: Just -- it should just be with
9 without a comma.

10 MR. THIMELL: That's agreeable.

11 CHAIRMAN MENDEZ: Thank you.

12 (Laughter)

13 MR. THIMELL: We try to please.

14 CHAIRMAN MENDEZ: You're still acting, Joel.

15 MR. THIMELL: I don't know why.

16 Section 2-1.8, that would be page 15 in the guide,
17 the suggestion was that the very last clause of subparagraph
18 (1) there was redundant, and the recipient would continue
19 this program or activity, discussing donated services and
20 the circumstances in which you would make a report as to
21 this, and we've already stated that the services would be
22 performed by salaried personnel to the extent funds were
23 available, and, therefore, that this paragraph -- that they
24 would continue the activities seems to be redundant.

25 We've agreed and would recommend taking that out.

1 CHAIRMAN MENDEZ: All right. Until somebody complains,
2 let's keep going. If there's no complaint about -- does
3 the field and the public have comments or have a copy of
4 Mr. Thimell's memorandum of October 25, and if there's no
5 objections to all of the comments and changes contained on
6 pages 1 and 2, the board will adopt those changes.

7 MR. WALLACE: I mean, let's hear what they are.
8 Let's go through them one at a time.

9 CHAIRMAN MENDEZ: Yeah. We have --

10 MR. WALLACE: Yeah. I've got the memo.

11 CHAIRMAN MENDEZ: Okay.

12 MR. WALLACE: I mean, I appreciate what he's doing,
13 going through it line by line to tell us what they mean.

14 MR. THIMELL: Sure.

15 CHAIRMAN MENDEZ: Okay. Please.

16 MR. THIMELL: Is that last one acceptable?

17 CHAIRMAN MENDEZ: Oh, yes.

18 MR. THIMELL: Section 2-1.12, and that would be
19 on page 18 of the guide, the very last sentence on that
20 page, "In this case, allocation of -- this is speaking about
21 allocation of expenses, particularly indirect costs to LSC
22 grants, and it's speaking about whether or not LSC would absorb
23 indirect costs from another grant activity, and the current
24 language states that LSC will absorb the indirect costs
25 associated with the grant as long as the grant activity in

1 question is eligible under the LSC Act and regulations and
2 do not exceed available resources.

3 And, I believe Mr. Simpson's point was that that
4 language there was superfluous given the deficit approval
5 requirements, and that this sort of creates a year-end problem
6 to something that, you know -- they're not going to know
7 about it in time to get the approval, and we've just agreed
8 that we should end the sentence after "LSC Act and regulations"
9 and add a new sentence simply reaffirming such allocation
10 is subject to the provisions of 45 CFR 16-28. That's the
11 fund balance regulation which speaks to approval for deficit
12 spending.

13 CHAIRMAN MENDEZ: All right. If there's no comment,
14 I mean, if you have a comment, let's just set the rules,
15 if you have a comment, stand up and make yourself known.

16 All right. Next one.

17 MR. THIMELL: All right. Section 2-2.5, that's
18 property records, page 22. Here, the comment was that we
19 were requiring that on each property card for each piece
20 of property that the programs owned would have to be a
21 specification of the actual depreciation method used for
22 that particular piece of property, and this would be a lot
23 of paperwork to go back through, you know, numbers of these
24 cards and, in fact, recording these methods, and the suggestion
25 was that you simply adopt a requirement for a written policy

1 on depreciation methods governing identifiable classes of
2 prpoerties.

3 I think that's reasonable, and we would suggest
4 that that be inserted as well.

5 MS. BERNSTEIN: Do you have the language?

6 MR. THIMELL: I'm trying to find that.

7 MS. BERNSTEIN: "The programs shall show established
8 a written policy on depreciation methods.", or are you wanting
9 us to establish the policy? That's my question.

10 MR. THIMELL: Right. Okay. After item 6, speaking
11 to depreciation methods should simply insert, I guess, "a
12 written policy on depreciation methods governing identifiable
13 classes of property.", or a notation on cards.

14 CHAIRMAN MENDEZ: Okay. Next?

15 MR. SIMPSON: Mr. Thimell?

16 MR. THIMELL: Yes?

17 MR. SIMPSON: Just a brief note. I believe that's
18 already part of the property management manual.

19 MR. THIMELL: In the same section, it was pointed
20 out in the first part of the paragraph there, "for financial
21 statement purposes, all capital items costing in excess of
22 \$500 with a useful life of more than one year must be capitalized
23 and depreciated.", it was felt there were some technical
24 problems in calling it capital there. Maybe it caused some
25 confusion, and that capital items should, in fact, be labelled

1 as non-expendable.

2 Section 2-4.1, page 28, under leasehold improvements,
3 and here the suggestion was that we not require, you know,
4 reporting of all items over a hundred dollars but would increase
5 that to \$500 for reporting of leasehold improvements on the
6 accounts, and we feel that's appropriate. Hard to improve
7 a leasehold for less than a hundred dollars.

8 CHAIRMAN MENDEZ: Can't even buy a window for that.

9 MR. THIMELL: Okay. Section 6- --

10 MR. WALLACE: Mr. Thimell, on the \$500 limit
11 that doesn't take into account very much of the leasehold
12 improvements, and the very basis in terms of minor repairs
13 could exceed \$500 limit.

14 CHAIRMAN MENDEZ: Well, what's your suggestion?

15 MR. WALLACE: I would suggest a minimum of a thousand.

16 CHAIRMAN MENDEZ: I would agree.

17 MR. WALLACE: On leasehold improvements, you can't
18 buy anything for less than a thousand.

19 MR. THIMELL: I wouldn't think you could, but this
20 is just making a record of the fact that you've done it.

21 This isn't a reporting requirement to us or anyone else.

22 MS. BERNSTEIN: I think -- I don't think that the
23 \$500 is a problem from the standpoint that I think that you
24 could -- you know, obviously, anything over \$500 will be --
25 if it's going to be over a thousand, it's going to be over

1 \$500. So, the question is would we, you know -- if, each
2 year, a room of carpeting was replaced, get a room of carpeting
3 for \$500 -- you know, I see what you're saying --

4 CHAIRMAN MENDEZ: What about -- let's make it \$750.

5 MR. WALLACE: Sold.

6 CHAIRMAN MENDEZ: Sold American.

7 MR. THIMELL: \$750?

8 Section 6-5, this is on the auditor's report to
9 LSC, and the note here is that the five items listed at the
10 bottom of the page that belong in the supplemental letter
11 from the auditor to the corporation on the financial statement
12 should be, in fact, consistent with those items which we
13 have noted previously on pages 5 and 6 of the guide.

14 There, we have six items, and the language is slightly
15 different. They are essentially the same requirement, but
16 we have stated them a little differently and we're proposing
17 an agreement that 6-5 here should be made consistent with
18 1-6.

19 CHAIRMAN MENDEZ: So, you just strike 1 through
20 5 and replace it with a through f?

21 MR. THIMELL: Right.

22 CHAIRMAN MENDEZ: You want to number them 1 through
23 6?

24 MS. BERNSTEIN: Yes.

25 MR. THIMELL: That's fine. Just to parallel the

1 section.

2 MS. BERNSTEIN: Just approve the same items?

3 MR. THIMELL: That's right. And 6-6 is a similar
4 comment. This is the auditor's opinion that's on page 70,
5 and there is a requirement that the auditor notify the
6 corporation if they uncover transactions that indicate weak-
7 nesses in the integrity of management during their audit.
8 We are to be notified immediately.

9 That language is somewhat different than the language
10 that is in 1-6 as well. In that section, they are required
11 to notify the corporation when these items relate to the
12 recipient's capabilities to safeguard an account for LSC
13 funds, and we were --

14 CHAIRMAN MENDEZ: So, you're going to substitute
15 1-6 at this point?

16 MR. THIMELL: We were proposing to combine the
17 two languages so that they are the same. In other words,
18 add weaknesses in management to 1-6 and add the safeguarding
19 accounts for LSC funds to 6-6, simply because LSC funds may
20 not cover all the waterfront.

21 MR. SIMPSON: I have a question.

22 MR. THIMELL: Sure.

23 MR. SIMPSON: You want to take the whole piece
24 from 6-6.

25 MR. THIMELL: Right. Weaknesses in the integrity

1 of management.

2 MR. SIMPSON: Management problems.

3 MR. THIMELL: No, no, no. Weaknesses in integrity
4 of language, and, let's see, Appendix 6, begins on page
5 116, and we're in the process of completely updating this
6 to square this appendix, which is on the functional classifi-
7 cations of expenses to, in fact, conform to the policy adopted
8 by the board in New Hampshire.

9 CHAIRMAN MENDEZ: Is this the new Appendix 6? Is
10 it a proposal or is it an informal thing?

11 MR. SIMPSON: That is a sentence that has been
12 removed.

13 MR. THIMELL: Yeah. We hoped to have it for you
14 this afternoon. It's being corrected right now at headquarters,
15 and we hope to have some copies here shortly. I just wanted
16 to bring it to your attention that there's a whole section
17 that's being revised in that mind, but there are some specific
18 changes that have been made in response to the PAG comments
19 that I wanted to go ahead and close out with this block.

20 The first one was under the statement of purpose,
21 we agree that improved priority setting and allocation of
22 resources is an important reason for functional accounting
23 of expenses, and that should be included in that paragraph
24 on purpose, on page 116.

25 The next item --

1 CHAIRMAN MENDEZ: Yeah.

2 MR. SIMPSON: I completely agree that those are
3 correct statements for potential betterment. However, it
4 should be noted that my comments were in the context of the
5 statement there now, that functional accounting would lead
6 to more legal services within existing budget constraints
7 was not acceptable by me. I think that's not an accurate
8 statement. It's not more services. It may be other management
9 benefits. They're adding without taking out what --

10 MR. THIMELL: Well, we, we disagreed --

11 CHAIRMAN MENDEZ: I understand what you're saying.

12 MR. THIMELL: We disagreed with his --

13 CHAIRMAN MENDEZ: You agreed to add some of his
14 statements, but you did not agree to take away some of his
15 requests.

16 MR. THIMELL: Yeah. That's correct.

17 CHAIRMAN MENDEZ: Comply with some of his requests.
18 I understand that.

19 MR. THIMELL: Okay.

20 CHAIRMAN MENDEZ: We understand that you're going
21 to come back through on the draft proposal.

22 MR. WALLACE: Are those the copies we have been
23 waiting for?

24 MR. THIMELL: Yes, sir. They are.

25 CHAIRMAN MENDEZ: Is there anything else on functional

1 accounting?

2 MR. THIMELL: Yes, there is. Yes, there is.

3 The next item was on page 118, under functional
4 area column headings. This is describing how you construct
5 the statement and there was the parenthetical note near the
6 bottom of that paragraph that in determining which priorities
7 should be reported or which service areas should be reported,
8 that perhaps ten to fifteen percent or above a \$100,000 would
9 need specific disclosure would suggest that we delete that
10 and we have, in fact, done so, in this revised paragraph.

11 MR. WALLACE: Do we have any guidance then on what's
12 substantial and what isn't?

13 MR. THIMELL: I Don't --

14 MR. WALLACE: Twelve and a half percent maybe?

15 MR. THIMELL: Is there a precedent for that?

16 MS. BERNSTEIN: Now, we've decided --

17 MR. THIMELL: No. I think that whole paragraph
18 has been condensed considerably, and, in fact, we are not
19 even going through and talking about substantial and non-
20 substantial. We're simply noting in the revised language
21 that --

22 MR. WALLACE: Okay. Well, until I see the revised
23 language, it's not -- you know, I can't --

24 MR. THIMELL: Sure. Well, we'll be going back
25 through that. We're in the process of --

1 MR. WALLACE: Stapling together.

2 MR. THIMELL: -- stapling it together. You'll
3 have the whole item in front of you.

4 CHAIRMAN MENDEZ: Well, I'll tell you what I would
5 prefer. I don't want to touch base on this.

6 MR. THIMELL: Okay.

7 CHAIRMAN MENDEZ: Let's not go through the thing
8 twice.

9 MR. THIMELL: All right.

10 CHAIRMAN MENDEZ: Is the board in agreement with
11 adopting all of the proposals, paragraphs numbered 1 through
12 7, as explained by Mr. Thimell? Not the board, the committee.
13 All in favor, (say aye.)

14 (Chorus of Ayes.)

15 CHAIRMAN MENDEZ: Opposed? (No response)

16 CHAIRMAN MENDEZ: Okay. Now, are there any other
17 additions or changes?

18 MR. THIMELL: Yes.

19 MR. WALLACE: Other than Appendix 6.

20 CHAIRMAN MENDEZ: Other than Appendix 6.

21 MR. THIMELL: Yes, yes. Section 2-1.4, this was
22 touched upon earlier, page 12. This is, again, dealing with
23 the functional classification of expenses, and the last para-
24 graph on page 13 needs to be revised to note that instead
25 of saying "although functional reporting expenses is not

1 mandatory at this time, each recipient should assess the
2 changes that will be required to comply with functional
3 accounting. The recipient should explore adopting functional
4 reporting in advance of any formal requirements."

5 That needs to be rewritten to reflect that the
6 board has adopted as policy that the LSC and its recipients
7 will use functional accounting in calendar year 1986.

8 CHAIRMAN MENDEZ: I have no difficulty with that.
9 The board has no difficulty -- I mean, --

10 MR. THIMELL: Yeah. Right.

11 MR. WALLACE: What -- are we going to do anything
12 except change recommends to direct? ,

13 MS. BERNSTEIN: I would just get rid of that paragraph
14 that says board of directors as stated on functional accounting.

15 MR. THIMELL: Programs should begin --

16 MS. BERNSTEIN: Begin.

17 MR. WALLACE: Am I correct in the last paragraph
18 on page 12, directs or recommends, it's the --

19 MS. BERNSTEIN: Oh, I see what you're saying.

20 MR. WALLACE: -- fourth line near the bottom. Oh,
21 I'm sorry. There's another paragraph at the top of the page.
22 I'm doing the best I can.

23 MR. THIMELL: Yes. Where are -- I'm not sure where
24 this direct is. What page are we on now?

25 MR. WALLACE: Bottom of 12.

1 MR. THIMELL: Accordingly, the corporation recommends.

2 MS. BERNSTEIN: Yeah. The corporation directs.

3 MR. WALLACE: We're not talking directed somebody
4 two weeks ago.

5 MR. THIMELL: Is direct --

6 MR. WALLACE: It's a good verb.

7 CHAIRMAN MENDEZ: Yes.

8 MR. THIMELL: Okay.

9 MR. WALLACE: Now, Joel, I apologize for completely
10 missing what you were doing on the last paragraph. So, I'll
11 shut up.

12 MR. THIMELL: Well, you caught an important point,
13 I think.

14 Are we agreeable then on the last paragraph --

15 MS. BERNSTEIN: May I just --

16 MR. THIMELL: That the board adopted a policy state-
17 ment on October --

18 MR. WALLACE: If we just direct --

19 MR. THIMELL: In the previous paragraph? .

20 MR. WALLACE: In the previous paragraph, do we
21 need this last paragraph?

22 MR. THIMELL: We'll delete it and leave see Appendix
23 6.

24 CHAIRMAN MENDEZ: Yeah. We may need to tell them
25 what we meant, but we don't need this.

1 MR. THIMELL: Yeah. Okay. That's fine. Okay.

2 There's also a minor --

3 MR. SIMPSON: Just a second.

4 MR. THIMELL: I'm sorry.

5 MR. SIMPSON: As you know, --

6 CHAIRMAN MENDEZ: Can you people hear him? No?

7 MR. SIMPSON: I'll stay here for the moment.

8 As you know, I would like to be heard with regard
9 to the whole question of manner and method of implementation.
10 The statement that's been introduced just now, which says
11 requires without further elaboration, obviously is subject
12 to misunderstanding. I assume the committee would prefer
13 to discuss this issue not at this instance, but some time
14 during the afternoon, because it will obviously be an extended
15 discussion, and I suspect the staff has recommendations on
16 this and they may become -- this may not be a difficult issue.
17 I'm not sure.

18 Required without any elaboration about the stages,
19 I think, may be the problem.

20 MR. WALLACE: Having suggested that word, I fully
21 agree. I mean, we told people that we want them to do it.
22 I think we are obligated some time today to tell them what
23 it is we want. This is --

24 MS. BERNSTEIN: What's --

25 MR. WALLACE: Well, I think we are going to get into

1 further details, and I think we're all agreed.

2 CHAIRMAN MENDEZ: Okay. Next?

3 MR. THIMELL: On --

4 CHAIRMAN MENDEZ: And, we're deleting the last
5 paragraph of that section.

6 MR. THIMELL: Right.

7 CHAIRMAN MENDEZ: Putting in the appendix 6 at
8 the bottom of this paragraph.

9 MR. THIMELL: Okay. On page 56, the criteria used
10 to evaluate the financial criteria, review Section -- there's
11 a mention, garbled, as to typographical problems dealing
12 with cost center and functional budget versus actual. I
13 think this needs t be cleaned up here.

14 Also to note with the asterisk that this is
15 recommended. It states here it's recommended, not required.
16 So, we would need to delete that optional language as well
17 and make it functional accounting.

18 CHAIRMAN MENDEZ: And, we're going to delete cost
19 center.

20 MR. THIMELL: Correct.

21 CHAIRMAN MENDEZ: Got it.

22 MR. SIMPSON: It seems to me you don't want to
23 stop the programs, stop calling on programs as an important
24 part of internal controls for maintaining cost center reporting.

25 CHAIRMAN MENDEZ: That's correct. I take that back.

1 We want to have that because that -- we want to allow them
2 to do cost center reporting, but mandate --

3 MR. THIMELL: We need to separate the two elements
4 in two separate --

5 MS. BERNSTEIN: Put an "and" in there. Cost center
6 and.

7 MR. THIMELL: Simply to clarify.

8 CHAIRMAN MENDEZ: Cost center, put an "and" instead
9 of a slash.

10 MS. BERNSTEIN: And functional.

11 MR. THIMELL: That's fine.

12 MS. BERNSTEIN: The slash means either or.

13 MR. THIMELL: All right. Okay. Let's see.

14 There's also a suggested change we have in Section 2-1.9,
15 page 16, dealing with recommendation of grant and contract
16 support. I'm sorry for skipping around so much. This is
17 the last item I have.

18 Page 16, very bottom of the page. This is the
19 last paragraph, deals with FIFO or first in first out accounting,
20 the requirement that all LSC funds be expended on a first
21 in first out basis. We also felt that to clarify what we
22 meant here, that all LSC funds should be expanded to include
23 the investment income.

24 So, it should read "LSC funds, including investment
25 income, derived thereon --

1 MR. WALLACE: There from?

2 MR. THIMELL: There from, excuse me.

3 CHAIRMAN MENDEZ: Now, investment -- you mean the
4 interest income --

5 MR. THIMELL: Interest income from stock, bonds,
6 dividends, whatever.

7 MS. BERNSTEIN: Do you really want the word derivative
8 income?

9 MR. WALLACE: Investment income derived there from.

10 MR. THIMELL: Is -- is -- is there a value in saying
11 derivative income as opposed to investment income?

12 MR. WALLACE: Maybe you ought to just say income.

13 MR. SIMPSON: The sale of the publication has been
14 a factor in the past.

15 MS. BERNSTEIN: That's not an investment.

16 CHAIRMAN MENDEZ: Do you have suggested language?

17 MR. WALLACE: Well, I mean, I think once you've
18 said, what it's derived from, I mean, I don't think you
19 have to say whether it's an investment or whether it's
20 derivative. Why don't you just say all LSC funds, including
21 income derived there from, would cover all forms of income.
22 Now, maybe there are some forms of income we don't want to
23 cover, but if we do want to cover --

24 MS. BERNSTEIN: That's okay. That's okay. My
25 only concern is investment is limiting.

1 CHAIRMAN MENDEZ: Do you have that language, Joel?

2 MR. WALLACE: Including income derived there from,
3 and those funds, probably.

4 MR. THIMELL: Yeah, yeah, yeah, and those funds.

5 CHAIRMAN MENDEZ: Held by separate entities.

6 MR. SIMPSON: At various times during the discussions,
7 we've noted the application of these provisions to the
8 corporation as well as to field programs, although the audit
9 guide explicitly does provide.

10 I would note that this board has been holding invest-
11 ment income since 1976 or '77, and that under this policy,
12 it would lose its character as a separate fund before the
13 end of the coming fiscal year if you adopt it. It seems
14 appropriate, if we play by the same rules, but that's a \$4
15 or \$500,000 amount at this point that you're holding separate
16 on your books.

17 MS. BERNSTEIN: Mike, you want to say anything?

18 MR. COSTER: It seems that although the corporation
19 is anxious to apply many of the same guidelines for improvements
20 in management to its Washington offices as it to the many
21 recipients, this is an area where the corporation may have
22 the legal responsibility or responsibility of Congress to
23 serve these clients. This has been a problem before in some
24 specific areas.

25 Therefore, this seems to be one of the few areas

1 where the restrictions or a guideline is being imposed
2 legitimately on recipients but cannot practically be imposed
3 on the corporation.

4 CHAIRMAN MENDEZ: For the record, let's introduce
5 Mike.

6 MR. COSTER: My name is Mike Coster.

7 MR. WILLIAMS: Mike is representing my office.
8 Fred Williams, head of monitoring audit and compliance.
9 I think I would put one gloss on what Mike just stated, that
10 I think the corporation should, to the extent it does not
11 have legal obligations to maintain a set of funds, and obviously
12 this proposal is not intended to override any court order
13 or other similar obligation we may be under, but with that
14 caveat, I would suggest that it should be applicable to the
15 corporation's own funds.

16 Whatever some court has ordered us to do or we
17 have some other legal obligation to do, I think we --

18 MS. BERNSTEIN: The corporation should no more
19 hold 1984 funds for use later than the recipients.

20 MR. COSTER: Exactly. Unless there's a specific
21 legal obligation to do so.

22 MS. BERNSTEIN: Plus we have to commit those funds
23 for a particular --

24 CHAIRMAN MENDEZ: If it's then allocated, under
25 our policy, it's allocated until expended.

1 MS. BERNSTEIN: Right.

2 MR. COSTER: And, I would suggest that the board
3 receive a report to the effect of what obligations on those
4 dollars still exist, what balances of those dollars exists
5 specifically for the up and coming years. They have not
6 yet been --

7 CHAIRMAN MENDEZ: Who should I get to do that?

8 MR. WILLIAMS: I think the president or whoever
9 he designates.

10 CHAIRMAN MENDEZ: Joel. The president's not here.
11 I don't see him.

12 MR. WILLIAMS: You volunteer?

13 CHAIRMAN MENDEZ: So, you would get some information
14 about that.

15 MR. SIMPSON: Yes. Just to follow up on Mrs.
16 Bernstein's comments. Certainly, programs would not be able
17 to hold money aside as committed until expended in the manner
18 that the corporation policy in managing its budget now
19 anticipates. So, again, we do have a discrepancy here and,
20 indeed, without a comment on this provision later, I'll be
21 urging you to allow programs the same flexibility you give
22 yourself.

23 CHAIRMAN MENDEZ: It might be a little bit more
24 convenient if we could drag that microphone up there, up
25 right by your --

1 (Pause)

2 CHAIRMAN MENDEZ: Okay. Gerry, are you about to
3 be put together again?

4 MR. SIMPSON: Yeah. I think so.

5 CHAIRMAN MENDEZ: Thank you. I'll move you up
6 one. When we're playing with all of these audit and accounting
7 and all these type things, everybody has plenty of paperwork.

8 Next?

9 MR. THIMELL: That, that is, in fact, our last
10 recommended change to the guide, as it sits before you, and
11 at this point --

12 MR. WALLACE: Now, as near to perfection as
13 human ingenuity can make.

14 CHAIRMAN MENDEZ: Now, I've been told, and correct
15 me if I'm wrong, except for a couple of typographical and
16 technical corrections, that you have met with Mr. Simpson
17 and he has advised you of, that we may not have covered
18 here, but there is a typographical error.

19 MR. THIMELL: That's correct.

20 CHAIRMAN MENDEZ: All right. And, the other matter
21 that we will do is before the board meeting in November,
22 we will have a completely revised --

23 MR. THIMELL: Clean copy.

24 CHAIRMAN MENDEZ: -- clean copy of the guide. Now,
25 do we have Appendix 6 or should we take all other issues,

1 aside from Appendix 6 first?

2 MR. COSTER: You have Appendix 6, which is three
3 sheets. The front sheet is loose. At your table. There
4 are more copies here.

5 CHAIRMAN MENDEZ: Does everyone have that?

6 MR. COSTER: Mr. Chairman, I would point out one
7 more change in the area of technical changes, and that is
8 in the sample financial statements contained in the main
9 body of the audit guide, some lucid comments have been brought
10 in as to how those statements might more typify the average
11 program. There's some unusual financial figures. While
12 the statements aren't intended to be strict guidance, Mr.
13 Simpson has recommended that some changes might make them
14 look more realistic, more, in fact, the way monitoring audit
15 and compliance would like to see many of the programs
16 performing.

17 Therefore, although it's a little bit more than
18 a technical correction, Mr. Simpson has offered to work with
19 the staff and make changes. So this, in fact, all involved
20 could be changed in the numbers, in the balance sheet, and
21 what have you, that they be allowed as well.

22 MS. BERNSTEIN: Just that illustration.

23 MR. COSTER: They are intended to be illustrations,
24 and we have made that clear.

25 MS. BERNSTEIN: They are just -- as they are,

1 they're not typical.

2 MR. COSTER: That's right.

3 CHAIRMAN MENDEZ: Are there any other comments?
4 Have you had a chance to review these -- this Appendix 6
5 that you have given us?

6 MR. COSTER: Yes, sir.

7 CHAIRMAN MENDEZ: Is it as correct as you believe
8 that it ought to be?

9 MR. COSTER: There are no further corrections from
10 the staff to the document that you have in front of you,
11 the three page document, with the loose front page. If you
12 have a stapled front page, you have the invalid version.
13 You don't have the current --

14 CHAIRMAN MENDEZ: You don't have the complete version.
15 You ripped off the front page and you have a loose front
16 page.

17 MR. COSTER: Yes.

18 MS. BERNSTEIN: The front page that you're saying
19 is current and what you're submitting should be labelled
20 10/25/85 in the left hand corner as your submission.

21 MR. COSTER: And, between the first and second
22 paragraphs is a large whited out area, as a distinctive indicatio

23 MR. WALLACE: Okay.

24 MS. BERNSTEIN: Oh, okay.

25 CHAIRMAN MENDEZ: All right. What we will do

1 is let's take comments about the audit guide up to Appendix
2 6, and we'll give -- we'll take a break in twenty minutes
3 or so or however long and let everybody review the Appendix
4 6.

5 Gerry, would you like to make a comment?

6 MR. SIMPSON: Certainly, Mr. Chairman.

7 CHAIRMAN MENDEZ: Give him enough room to spread
8 out his papers.

9 MR. SIMPSON: Advantage of having written something
10 so close before you speak about it is that you haven't had
11 time to figure out a different way to say it, so you don't
12 need as many notes.

13 First, Mr. Chairman, I'd like to request that the
14 memorandum you have from the Project Advisory Group, dated
15 October 24, 1985, and attachments, be entered into the record
16 of the committee.

17 CHAIRMAN MENDEZ: That's fine. Do you have an
18 extra --

19 MR. SIMPSON: I have given one to Mr. Bayly, and --

20 CHAIRMAN MENDEZ: We'll make sure that it's attached.

21 MR. SIMPSON: Thank you.

22 CHAIRMAN MENDEZ: We'll make sure that it's attached
23 to the complete record.

24 MR. SIMPSON: Second, basically, I think there
25 are three types of questions that I would like the committee

1 to consider before it acts on the proposed audit guide.

2 The first set of questions have really been
3 discussed before, and I want to raise them, the committee
4 will need to decide them, but I'm not sure we have to argue
5 about them because the positions have been heard at length,
6 both in this committee and in other committees. They have
7 to do with the appropriate method for adopting and putting
8 into force the audit guide as a rule, regulation or guideline
9 for the corporation.

10 The second group of issues have to do with functional
11 accounting, and my basic plea to you is that in the course
12 of this afternoon's meeting, you give the staff some directions,
13 which I'll speak to in more detail, with regard to how you
14 want them to proceed in developing the ideas, the nature
15 of, the method of implementation of, and the content of
16 functional accounting in field programs pursuant to your
17 policy statement of October 11th, the board's policy
18 statement.

19 It is my hope that the staff, working in cooperation
20 with field programs, will develop some workable, effective,
21 meaningful approaches to functional accounting, which will,
22 in fact, have the kind of benefits that are potentially avail-
23 able from functional accounting, without having the kinds
24 of costs that would overwhelm the benefits.

25 And, what I would hope you would recommend and

1 ask the staff to do is to come back to you with a report
2 which lays out their conclusions and what those approaches
3 are, so that we have a clear set of guidelines for where
4 we're going on functional accounting, before programs begin
5 to make willy-nilly transitions that will be expensive and
6 then superseded by the results of subsequent staff
7 conclusions.

8 The third set of issues are a series, now somewhat
9 reduced by the staff's proposals, of specific issues, perhaps
10 nine or ten, I think, are left, with regard to the audit
11 guide provisions, which I would hope to go through with you.

12 How would you like to proceed with those three
13 issues?

14 CHAIRMAN MENDEZ: Let me tell you, at four o'clock,
15 I am adjourning because I have a plane to catch, and you
16 touched -- Gerry, I'm going to let you go in whatever order
17 you want to go, but that's an hour, that's more than they've
18 gotten, but that's -- I want to give you plenty of time,
19 and I want you to be aware of my time limits.

20 MR. WALLACE: Mr. Chairman, let me say this, as
21 to the regulatory thing, I went through this myself and I
22 think the general counsel's office did, too.

23 General Counsel's office reported this morning
24 that they thought we could do every thing in here by accounting
25 guide rather than by regulation.

1 My own judgment that we needed to do question cost
2 by regulation, and that's what my committee worked on this
3 morning. My own sentiment is that as for what else is --
4 as for every thing else that is in here, I don't think it
5 is so substantive that it requires a regulation. Now, that's
6 a seat-of-the-pants opinion, but it's a seat-of-the-pants
7 opinion that happens to agree with what our general counsel
8 has done, and I'm reasonably satisfied that what's left in
9 here can be done in this way.

10 May be wrong, but that's my feeling, and given
11 the scarce time of the committee, since I was the only one
12 who thought any of it ought to be done by regulation, Mr.
13 Simpson, you might want to move on to the other things and
14 try to convince the full board, when you get to Santa Anna.

15 MS. BERNSTEIN: Or the -- I was going to say the
16 ten items would be my preference to go through first.

17 CHAIRMAN MENDEZ: Gerry, I think we would like
18 to address the ten items. You do whatever way you want to
19 do it, but I would like to see the ten items --

20 MR. SIMPSON: I think you reminded me about this
21 two weeks ago, and what one does in court.

22 CHAIRMAN MENDEZ: You know, my wife told me that
23 I shouldn't have done that. Well, I'll save my other comment
24 for a little bit later, and we'll --

25 MR. SIMPSON: Very good.

1 With regard to Mr. Wallace's comment, the only
2 point I would make is the four items on pages 3 and 4 of
3 our memorandum were inserted for the first time as significantly
4 different material and haven't been noticed in any effective
5 way until the October 10 document. The October document.

6 As to those, perhaps the General Counsel could
7 give a report at the meeting in Santa Anna as to whether
8 some steps to enforce is required.

9 I will let the record stand for itself on the legal
10 issues otherwise.

11 As to functional accounting, --

12 CHAIRMAN MENDEZ: Excuse me. Do you have Mr. Simpson's
13 memorandum?

14 MR. BAYLY: I have the memorandum.

15 CHAIRMAN MENDEZ: October 24?

16 MR. BAYLY: October 20th letter, and I guess the
17 two follow-ups, yes. I do have it, yes.

18 MR. WALLACE: Gerry, don't take the time, there's
19 plenty floating around, and we'll get it later.

20 MR. SIMPSON: As to functional accounting, I will
21 pass it for the moment with the hope that we can come back
22 to it. Frankly, it is my hope that we will hear before the
23 afternoon is over a proposal from staff regarding how it
24 intends to proceed. If that proposal contains the elements
25 that I have described here, why, then, we have a simple issue.

1 So, I'll pass it and talk about the substantive provisions.

2 CHAIRMAN MENDEZ: That's fine.

3 MR. SIMPSON: However, I need to say that in my
4 time management, if four o'clock is the deadline, that I
5 need to come back to functional accounting because its
6 implications are greater than all the rest.

7 CHAIRMAN MENDEZ: How much time do you want for
8 that?

9 MR. SIMPSON: For functional accounting? I can
10 say what I need to say in about ten minutes.

11 CHAIRMAN MENDEZ: Okay. We'll make sure to provide
12 that time. At 3:50, we'll drop everything else and come
13 back to it.

14 MR. SIMPSON: Hopefully, the substantive provisions
15 won't take that long.

16 CHAIRMAN MENDEZ: Okay.

17 MR. SIMPSON: If you can turn to page 15 of my
18 memorandum, that's where we begin the discussion of specific
19 substantive issues.

20 CHAIRMAN MENDEZ: Now, this is your October 25th --

21 MR. SIMPSON: This is the October 24th memo, and
22 not its appendices in terms of page 15, although none of
23 the appendices have 15 pages.

24 The first issue here is a straightforward one.
25 Under Section 1009(c)(1) of the Legal Services Corporation

1 Act, the Corporation has the power to conduct audits of local
2 programs, and it has the power to direct local programs to
3 provide audits.

4 However, the audit guide, in Chapters 1-5, 1-6
5 and 6-2, states that the Corporation reserves the right at
6 its discretion to select the local programs independent auditor.
7 I'm adding the words "local programs independent" to make
8 the context clear.

9 Citing 109(c)(1). The issue here is that under
10 the Act, the authority to appoint the auditor that must then
11 be used by the local program as its auditor is not granted.
12 We have two suggestions.

13 First, the original draft of the guide had two
14 other powers in mind; one, the power to do your own audit,
15 which is clear under the Act, and we have no objection to
16 that. The second, the power to stop a program from using
17 an auditor who, for a variety of suggested reasons, wouldn't
18 be appropriate to continue doing the independent audit of
19 the program.

20 We have no objection to that idea. The objection
21 lies in the imposing of a particular auditor on a local program.
22 We think that raises two kinds of problems.

23 First, the legal problem under 109(c)(1) and, second,
24 although it is not probably insurmountable problem, it certainly
25 raises a two masters problem for the auditor. It can be

1 solved by an efficient, carefully-worded agreement. There
2 are certain ethical problems, for example, with regard to
3 client trust funds that can be solved through the audit agree-
4 ment, but there are problems.

5 So, what we would propose is, first, that you go
6 back to the earlier provisions, that you'd be able to preclude
7 and obviously that you'd be able to audit yourself, but that
8 you not assert the authority to appoint the auditor; or,
9 second, if you feel you must have the stated authority to
10 appoint, that you at least indicate that you will exercise
11 that authority only in cases of good cause.

12 MR. WALLACE: Why do we need the language permitting
13 us to appoint the auditor they are going to pay as opposed
14 to doing what is in the original guide?

15 MS. BERNSTEIN: Mike?

16 MR. THIMELL: No. I think this -- this provision
17 was put into maintain the maximum flexibility of the corporation
18 to, in fact, select auditors whenever we think they may be
19 necessary. I think our reading of that same section very
20 clearly gives the corporation the right to conduct these
21 audits.

22 I don't see any problem with conducting the audit
23 through an instrumentality as opposed to sending an employee
24 of the corporation to do that, and that's all we're saying
25 is that we have the right to do it ourselves or through an

1 instrumentality at our discretion, and all we were trying
2 to do there is instead of making this narrow statement that
3 we may preclude auditors, we didn't want people to think
4 that we didn't claim the right to, in fact, select auditors,
5 which is what we feel is, in fact, our right.

6 MR. WALLACE: I presume that when we do our own
7 audit, we pay for it, and when a program does its own audit,
8 they pay for it.

9 MR. THIMELL: That's correct.

10 MR. WALLACE: Are we saying that we can select
11 an auditor and they pay for it? Is that the way it reads
12 now? I mean, maybe we can do that, and maybe that's not
13 so bad, but I'm trying to understand if that's what it is
14 we're saying.

15 MR. THIMELL: I'm not sure it says that specifically.
16 It could be read to mean that, I suppose, and if that's a
17 problem, I think it could be -- the language could be improved
18 to say that LSC shall -- can contract -- would contract with
19 the auditor as well, and, in fact, it would select and contract
20 with the auditor, by making it clear that we would be paying
21 for it and it would clear up his ethical concerns as well.

22 MR. SIMPSON: I would have no objection to language
23 saying what Mr. Thimell just said, that LSC can conduct its
24 own audit either through its staff or through an instrumentality
25 it chooses.

1 CHAIRMAN MENDEZ: I agree with that.

2 Does the committee agree? Is there any difficulty on the
3 committee with that amendment or that modification?

4 MS. BERNSTEIN: The only -- the only concern that
5 I want to get on the table, because I know this is in other
6 peoples' minds because, Gerry, you have been through this
7 with the board --

8 MR. SIMPSON: Twice, actually.

9 MS. BERNSTEIN: At one point, the board -- the
10 board has been faced, at various times, with the possibility
11 of having a uniform auditing system or having a company do
12 all the audits, and if -- I don't want this discussion here
13 to preclude our making that policy decision like that at
14 a later date, but that is not what this is talking about.

15 CHAIRMAN MENDEZ: No. That's not --

16 MS. BERNSTEIN: Okay. But I'm simply saying that
17 if that is the situation, then that would not mean that we
18 had -- I mean, I presume at that point, something would be
19 worked out regarding who paid for it, but that's not the
20 problem that we're dealing with here.

21 MR. THIMELL: All we're saying is that the corporation
22 would, in fact, contract with the auditor and that clears
23 up particularly the ethical dilemma of when we pick the auditor
24 and they work out the contract.

25 CHAIRMAN MENDEZ: All right. The corporation can --

1 are you saying the corporation can pick the auditor --

2 MR. THIMELL: And contract with the audit.

3 CHAIRMAN MENDEZ: And, who pays?

4 MR. THIMELL: We do.

5 MS. BERNSTEIN: At this point, we do.

6 CHAIRMAN MENDEZ: At this point, we would pay --

7 MS. BERNSTEIN: If it's a situation where the board
8 would deal with the question that's been brought up at various
9 times in the last few years about whether or not there's
10 going to be a uniform auditor for all the programs, then,
11 obviously, we can deal with the question --

12 CHAIRMAN MENDEZ: Yeah. I don't think this forecloses
13 either option. That's fine.

14 MR. SIMPSON: I would note for the record that
15 other half of what I said, which is that there ought to be
16 a good cause statement if you're going to take it over,
17 but this is obviously a real improvement over what was there.

18 CHAIRMAN MENDEZ: All right. Yes. You're not
19 going to include a good cause statement in there. You know
20 what we want, basically.

21 MR. SIMPSON: The second --

22 CHAIRMAN MENDEZ: Just a moment.

23 MR. VASALY: I'm sorry, Gerry. Are you going to
24 spend any time for any other public comments? This is a
25 long memo which I haven't seen before on this particular issue.

1 At 3:58 maybe.

2 CHAIRMAN MENDEZ: Okay.

3 MR. THIMELL: Mr. Chairman, he's going to have
4 to come up to the microphone to be heard at all.

5 CHAIRMAN MENDEZ: Okay. We'll make sure that we
6 get time before we move on this thing.

7 MR. VASALY: I have one other -- I have another
8 angle, I think, on this question of the auditor.

9 CHAIRMAN MENDEZ: Okay.

10 MR. SIMPSON: My principal has something he wants
11 to say.

12 MR. MOLA: I stepped out, but I think you were
13 clarifying the language in the audit guide about the corporation
14 doing an audit or doing it through someone they may hire,
15 a consultant or an instrumentality.

16 I would just point out that there is a conflict
17 now, if that is your position, with assurance paragraph 8
18 in the funding application, and perhaps we can simply have
19 that assurance coincide with the language --

20 CHAIRMAN MENDEZ: We'll make sure that the language
21 on both of them are --

22 MS. BERNSTEIN: That's fine.

23 MR. MOLA: In the 1986 refunding application.

24 CHAIRMAN MENDEZ: We'll make sure that the refund --
25 the '86 application complies with this.

1 Tom, you're really good at making these notes,
2 so why don't you make sure that you keep notes along with
3 all of the -- with Mike and Joel because we've got three
4 memories going through this, since most lawyers do not like
5 to mess with accounting. I'm sorry, Mike, but that's the
6 case.

7 All right. Next one?

8 MR. SIMPSON: The next one's on page 16 of the
9 memo, in chapter 1-6. There are two issues. One, I want
10 to mention but not push in the interests of time, although
11 I think it's in the nature of a technical amendment that
12 serves your interests.

13 We talked before about the auditor calling up when
14 the auditor finds something that suggests a problem of internal
15 control or some kind of untrustworthiness in management.
16 In the draft of the guide, that was limited to situations
17 in which those situations were of a serious nature. That
18 language has now been removed. The legislative history reading
19 would suggest any time you find anything that conceivably
20 fits the description, you have to call; I would suspect you're
21 interested in serious matters would urge you put the words
22 "are of a serious nature" back in, but given time, unless
23 the committee wants to respond, I would leave it to the staff
24 to consider that, since I think the staff made the amendment.

25 CHAIRMAN MENDEZ: Why was it taken out?

1 MR. THIMELL: In 1-6?

2 MR. SIMPSON: Yes.

3 MR. THIMELL: I think we simply didn't -- you know,
4 want to look like we were discouraging these reports and
5 the creating of a very high level of -- I think it's an auditor's
6 call there, does this relate to the capabilities to safeguard
7 these funds. If it's his opinion that it does, we want to
8 know.

9 CHAIRMAN MENDEZ: All right. Let me ask a question.
10 How many reports have you had in the past month? Numerous?
11 Not many?

12 MR. THIMELL: I don't think they've been very numerous.

13 CHAIRMAN MENDEZ: Gerry, during your career with
14 the corporation, were the reports from auditors numerous?

15 MR. SIMPSON: I honestly don't have any recollection.
16 They would have gone to Pat Yogas and in the ordinary course
17 of business, I wouldn't have known.

18 CHAIRMAN MENDEZ: Okay.

19 MR. SIMPSON: The second point in 1-6 is more sub-
20 stantive. It provides that in the circumstances where these
21 concerns arise, an auditor is obligated to call whether they
22 arise in the course of an audit or they arise in the course
23 of special work or other work of some kind done for the
24 recipient.

25 The problem here is very practical problem. If

1 somebody has got a question that they want confidential,
2 competent professional advise about, because they're nervous
3 about this situation, with this clause as it now reads, they'll
4 hire somebody who isn't their auditor.

5 CHAIRMAN MENDEZ: Okay. But that's -- isn't that
6 what an auditor's for, to give independent advice?

7 MR. SIMPSON: Absolutely, and if this provision
8 about making telephone calls in the context of special work
9 weren't there, then they'd still hire their own auditor because
10 that's exactly what they should do.

11 But, if they can't have a confidential conversation
12 about something they're nervous about, because of the risk
13 of confidentiality under this clause has to be breached,
14 if it deals with internal control weaknesses, they'll hire
15 somebody they can talk to.

16 I don't know why that's happening. Maybe I'm talking
17 too close to it.

18 CHAIRMAN MENDEZ: Yeah.

19 MR. SIMPSON: And, that's the point. We probably
20 want them to talk to their auditor. If they talk to their
21 auditor, when the audit is prepared, if there is any problem,
22 it will be disclosed. When the audit is prepared, if they
23 use their auditor and he doesn't have to call at that moment,
24 the audit is going to disclose the problem. Indeed, as soon
25 as he comes in to start the audit under this provision, he'll

1 have to make the contact with the corporation if there is
2 an internal control problem, or a trust problem.

3 So, we recommend that you drop the two references
4 to other work and special work, so that the program will
5 feel that they can have a confidential conversation outside
6 audit time with their auditor.

7 MR. THIMELL: Two points on that.

8 CHAIRMAN MENDEZ: Anybody on the committee agree?

9 MR. THIMELL: Two points on that. Number one,
10 this is basically a current provision of the audit guide,
11 that they report on any work that they are doing for the
12 recipient, and it has been rephrased to note special work
13 and keeping special work available for seven years, but,
14 basically, this is a current requirement that they notify
15 the corporation about special work, and as regards internal
16 control.

17 The second thing is simply that ten months may
18 be too long to wait to hear about an internal control problem.
19 That is, the guy calls you in January, you don't get an audit
20 until April, that's too late.

21 MR. SIMPSON: Well, of course, the simple answer
22 to that is they don't hire the auditor, you wait the ten
23 months, and, of course, the reason --

24 MR. WALLACE: Yeah, but if they don't hire the
25 auditor, I mean, that looks to me -- it is hard to imagine

1 any reason for hiring somebody that's not your auditor because
2 you don't want us to know what's going on, and that, to my
3 non-accounting way of thinking, waves the brightest red flag
4 I've ever seen. I mean, if I start seeing reports that our
5 people are going to non-auditors for special advice and I'm
6 not hearing about the advice they're getting, I'm really
7 going to wonder what's going on down there.

8 MR. SIMPSON: What if they go to a lawyer? Do
9 you expect to hear about the advice they get?

10 MR. WALLACE: Well, I dealt with that this morning.

11 MR. SIMPSON: I know. It is a similar problem.
12 That's really all I need to say. It's just a different
13 professional skill involved.

14 MS. BERNSTEIN: But the problem in terms of our
15 having an independent auditor, the same person that's giving
16 you advice on how to get around the thing, ought not to be
17 the person that we are relying on to take an objective view.

18 MR. SIMPSON: I think that's a potential problem.
19 The reality is, for the most part, the auditor gives advice,
20 he is going to tell you about it during the audit process.

21 CHAIRMAN MENDEZ: All right. Gerry, you've brought
22 it to our attention.

23 MR. SIMPSON: All right. The third point starts
24 on page 17, and is undoubtedly the most sensitive of these.
25 It has to do with the chapter on inter-related organizations,

1 Section 1-7.

2 We've already had a brief discussion on the change
3 on the first point on 17. On page 18, there's a mention
4 that you may have a comparable problem with regard to private
5 law firms being found to be controlling. I think it's too
6 small a problem to warrant our time at this moment, but your
7 language makes it possible for the private law firm on an
8 adjudicare contract basis is going to be found a controlled
9 organization.

10 Third is the important and, I think, more difficult
11 question, and I'm going to come to the conclusion of it rather
12 than going through all of the material that's in the
13 memorandum.

14 CHAIRMAN MENDEZ: The third point is on page?

15 MR. SIMPSON: Page 19. Doesn't end till page 21.

16 And, the essence of the third point, if you would
17 turn to page 7 in the audit guide, probably easiest to just
18 look at it there, the last paragraph of Chapter 1-7, reads,
19 "funds held by an organization which controls, is controlled
20 by, or is subject to common control with a recipient or a
21 sub-recipient are subject to the same restrictions as if
22 the funds were held by the recipient or sub-recipient."

23 In other words, a non-recipient's non-LSC funds,
24 private funds, are subject to the same restrictions as if
25 that organization were a recipient. This is in the context

1 of course, of what are colorfully referred to as mirror
2 corporations.

3 CHAIRMAN MENDEZ: What is wrong with requiring
4 them to do that?

5 MR. SIMPSON: It seems quite clear, at least on
6 the explicit language of 1010(c) that the private funds in
7 the hands of non-recipients are not subject to the Act, unless,
8 in fact, there is a legal doctrine which pierces the corporate
9 veil and combines the two organizations. There's no lawful
10 authority for extending that to the non-recipient, non-LSC
11 funds. There is one exception that I'll come to in a second,
12 the second half of what I want to suggest.

13 If the alter ego doctrine applied, there was fraud
14 or injustice, you could pierce the veil, make them a single
15 organization and apply the rules. If it doesn't apply and
16 even in the case of the Texas rural and south central programs,
17 GAO found it did not apply. GAO said you need an extension,
18 basically, a new concept, in order to reach those situations.

19 If you can't pierce, 1010(c) gives you no authority
20 to apply restrictions to private funds in the hands of non-
21 recipients. What I propose to you, however, is something
22 slightly different from just that flat conclusion because
23 I don't expect you to accept that conclusion so quickly.

24 What I propose to you is that you not publish this
25 sentence in this last part of 1-7 at this time because I

1 think it has some very difficult legal issues. In addition,
2 what I propose to you is that you go where GAO suggests you
3 go, since these organizations were formed, you've adopted
4 a sub-grant regulation, you've adopted a fund balance
5 regulation. You now have approval processes that deal with
6 the creation and operation of entities of the kind you're
7 concerned about.

8 I suggest to you that you propose an amendment
9 to 1627 on sub-grants, which states that inter-related
10 organizations, which is one of the things you want to look
11 at in sub-grant applications, and that if you find an inter-
12 related organization of the kind described here, in a sub-
13 grant application, then you're going to try to apply to the
14 private fund of the sub-recipient, the provisions of 1010(c).

15 Right now, Section 1627 does not attempt to do
16 that. My own personal opinion is that it is beyond the reach
17 of the corporation to do that without the alter ego doctrine
18 operating, but we shouldn't do it in the guise of a single
19 sentence in the audit guide, when it is so clearly a legal
20 act and so clearly extending the reach of the corporation
21 in at least a questionable way.

22 MR. WALLACE: Mr. Chairman, when I said a few minutes
23 ago that I thought most of this was pure accounting, I had
24 looked over this inter-related organization, and I think
25 it is pure accounting to tell us what's going on. This looks

1 reasonably substantive. I don't know how much my meeting
2 this morning you caught, but I do certainly share some concerns
3 about our reach to non-LSC private funds.

4 I'm going -- I mean, I'm going to be happy to leave
5 this in here as it is for purposes of what we're doing today,
6 but Mr. Bevard has been instructed during my committee meeting
7 to look at that problem by Chairman Durant from the next
8 board meeting to try to know where we're going on non-public
9 funds, and I would suggest that this is an aspect of the
10 same problem that General Counsel's office needs to be looking
11 at between now and the board meeting because I -- I mean,
12 obviously, we have a serious problem, -- we have a serious
13 problem that the GAO has told us about, and Mr. Simpson has
14 raised a serious legal question about whether this is the
15 way we can deal with it, and you've got a job to do.

16 CHAIRMAN MENDEZ: I think that what we will do
17 is we will publish it for the board's book, but that we will
18 listen to some phrasing which you have, Gerry. I would hope
19 that you could come in with something, and house counsel
20 will ask them and between the three different groups here,
21 we can come up with something.

22 MR. SIMPSON: Clearly, it would be acceptable to
23 simply say may be subject as opposed to are subject since
24 that would leave the issue open.

25 The next point I want to raise is -- I was actually

1 surprised that it wasn't part of the staff's amendments,
2 so I'd better raise it.

3 MR. WALLACE: Not at this point. Let's wait and
4 see. That's a simple one to do.

5 MR. SIMPSON: Page 21, item number 4, at the beginning
6 of Chapter 1-8, paragraph 2, page 8 of the guide. Page 8.
7 That's the way I'll do it from now on.

8 MR. WALLACE: Moving right alone.

9 MR. SIMPSON: Right. Page 8. The first two words
10 on the page are "any fund". However, this is taken from the
11 sub-grant regulation, which applies only to corporation funds,
12 and, so, the language should read "any corporation funds".
13 Otherwise, again, we have a substantial extension of what
14 the corporation was doing with regard to funds moving from
15 recipients to sub-recipients.

16 CHAIRMAN MENDEZ: This is the same issue as 4.

17 MR. SIMPSON: With one exception. This is regulated
18 already and we've explicitly got a regulation that only applies
19 to LSC funds in this context.

20 MR. THIMELL: We believe that the 1010(c) is broader
21 than the regulation on this particular matter, and that it
22 clearly requires that proper accounting for and expenditure
23 of these funds occur and that delegating of these funds in
24 a sub-grant would be constituting an expenditure of and,
25 therefore, this kind of language is called for and we'd be

1 happy to have it looked at in the same context as the other
2 question. But, we think that the sub-grant regulation, frankly,
3 could be broader than what it's currently constituted.

4 MR. WALLACE: I mean, I think it's just saying,
5 you know, you got the money, you let it out, tell us what's
6 going on. I wouldn't think this is substantive in the same
7 sense that the last problem might have been and, again, I
8 may show my lack of understanding of accounting, but I think
9 what this is asking for is any money that goes through your
10 hand, tell us what's going on with it, and I think that's
11 a reasonable thing that we ought to know. We may have a
12 legal problem with it, but I hope we don't because it's a
13 reasonable question.

14 MR. SIMPSON: Except for those aspects that overlap
15 with this morning's discussion, I agree with you. The problem
16 -- there's another problem, which is that we're quoting here
17 from a regulation but misquoting slightly. Indeed, we have
18 also, in this section, left out a provision which is a direct
19 audit provision, which allows a sub-recipient to arrange
20 with the audit division of the corporation for alternative
21 methods of ensuring the propriety of expenses by the sub-
22 recipient.

23 Since we have quoted half to two-thirds of the
24 regulation in three different places in this audit guide,
25 I'm at a loss to know why we left out an explicit audit

1 provision, but we did. I would certainly urge you to ask
2 the staff to include the deleted sentence which allows for
3 special exceptions on applications.

4 CHAIRMAN MENDEZ: Mike?

5 MR. WALLACE: I don't know enough about that regulation
6 to be able to comment intelligently.

7 CHAIRMAN MENDEZ: Excuse me, Mike.

8 MR. WALLACE: I'm sorry.

9 MR. COSTER: There's two things that are mentioned
10 by Mr. Simpson. The first is certainly -- well, we'll start
11 with the easy part. The second as to the alternative accounting
12 methods that can be arranged with the corporation, we would
13 agree that that is specific and limited clause should be
14 reintroduced to this paragraph.

15 CHAIRMAN MENDEZ: Okay.

16 MR. COSTER: However, the first, we differ with.

17 CHAIRMAN MENDEZ: Okay. That's fine. We'll add
18 the second one back in.

19 MR. SIMPSON: There's a third, which I raise only
20 because it's going to affect you more than anybody else.
21 Perhaps Mr. Wallace, and that is that if you quote a regulation
22 in the audit guide and then amend the regulation, you have
23 to amend the audit guide.

24 So that whatever process is involved for the audit
25 and appropriations committee in amending the audit guide,

1 will be invoked any time the sub-grant regulation is modified.
2 I'm not clear why we want to quote at length as opposed to
3 referencing the regulation, which contains all the language
4 that we're talking about.

5 MR. COSTER: Because the language of the regulation
6 is narrower than the intended scope of this paragraph of
7 the audit guide.

8 MR. SIMPSON: I'm talking about three different
9 sections of the guide, actually. One, I think it's 1, 1-
10 8 and 2-1.2, something like that, where you've got different
11 chunks of this regulation.

12 MR. WALLACE: Well, given the Chairman's plane
13 schedule, that is a problem I'm willing to deal with when
14 it arises. I understand the problem you're stating, but I
15 can live with this now.

16 CHAIRMAN MENDEZ: You may want to consider this.

17 MR. COSTER: We recognize it, but some appearances
18 of the verbatim language have been unavoidable for reasons
19 of using the audit guide.

20 MR. SIMPSON: Next, Chapter 1-9, which is on page
21 8, sets forth a requirement of prior approval for fiscal
22 year change. I understand the corporation to have two concerns
23 here.

24 One being that they would get eighteen month audits,
25 and the other being that someone would some time try to dodge

1 a regulation that was going into effect at the end of this
2 fiscal year by shortening their fiscal year so that this
3 didn't become subject to it until a year later.

4 Now, it seems to me that those two concerns can
5 be solved rather easily without having to interpose yourself
6 in the internal business of the state-chartered corporation
7 to this degree, an inter-position that I think raises some
8 legal problems by saying you've got to do a short year audit
9 if you change fiscal years and pinning your regulations to
10 the start of fiscal years rather than the end.

11 MR. COSTER: We'd like to expand the needs of the
12 corporation, which are much greater than those cited by Mr.
13 Simpson. We recognize no long audits are allowed, to begin
14 with. Twelve month audits are not -- twelve month plus audits
15 are not acceptable under GAAP typically. They are not acceptable
16 to the IRS whatsoever, and they're not acceptable to the
17 corporation whatsoever.

18 That's really not at issue. The overwhelming need
19 for the corporation to provide oversight, management,
20 responsibilities for the money that it's putting out, the
21 need to control the implementation of new regulations, which
22 Mr. Simpson did mention, the substantial increased work load
23 that is thrown on the corporation when a fiscal year is changed,
24 together with the evident custom of the grantee or the recipient
25 in the past of requesting permission or at least looking

1 for objections from the corporation prior to changing indicates
2 to us that that should be the actual process. We should adhere
3 to notice and requests of the corporation.

4 We've also examined from the legal perspective
5 whether or not that is an accepted intervention with the
6 management of the corporation, and have seen no evidence
7 of that. The examples that have been problems before involved
8 somewhat more overbearing interference.

9 MR. SIMPSON: Do you want to say more, Joel?

10 MR. THIMELL: No.

11 MR. SIMPSON: I, frankly, don't hear anything in
12 that to suggest we've got a need. This feels just like we
13 want to claim authority where we have no need, to create
14 a process that's only for the paperwork that gets done on
15 it. Oversight is not affected at all by change in fiscal
16 year. Workload of the corporation is not significantly affected,
17 although what happens is that the audit process -- that review
18 is shifted to a different time period.

19 The custom isn't even universal within the country
20 of checking out. Notices are no problem. You want notices,
21 of course, you'll get notices of change of a fiscal year.

22 So, I don't understand that this provision actually
23 is useful at all. Any further comment?

24 CHAIRMAN MENDEZ: No.

25 MR. SIMPSON: We have already discussed the provision

1 in 2-1.91 having to do with FIFO, somewhat earlier this
2 afternoon. I want to come back to it for a moment.

3 I had mentioned a couple of situations earlier,
4 the investment income account of the corporation, and the
5 rules regarding commitment. Both areas where there are differences

6 The third value of being able to segregate funds
7 to years of origin is exemplified by the way that the
8 corporation avoided a serious difficulty back in 1983, I think
9 it was, under the alien rider.

10 That problem had to do with the ethical
11 responsibilities of the program to continue representation
12 of aliens that couldn't be represented with current year
13 funds. The ethical responsibility was that withdrawal from
14 representation would have left those clients with no
15 representation and under the ethical code, you can't withdraw
16 in that circumstance because you're going to adversely affect
17 the client.

18 The solution to a lawsuit over the applicability
19 of the provision was the use of prior year funds in the hands
20 of the corporation as a special grant where it was needed,
21 to maintain representation without using new money.

22 What we propose to you is that it is useful to
23 be able to designate funds at the time they are granted.
24 Obviously within the ten percent fund balance rule. We're
25 not talking about large amounts of money, generally, for

1 purposes permitted with those funds so that important types
2 of representation, like the alien representation, can continue
3 in an ethical fashion.

4 We have not had a chance to research this issue.
5 The earlier proposal contained the exception, allowing
6 designated funds, and my own guess is that there are very
7 few such funds out there that are earlier year funds, enough
8 earlier so that it matters.

9 So, I'm not making a representation at this time
10 with regard to the magnitude of this issue. But, it seems
11 to me a wise issue and conceivably you have a legal issue
12 to check out in terms of the settlement agreement in that
13 case. I don't know what continuing representation of illegal
14 aliens now goes on from '82 and before.

15 It would be very good representation, if it was
16 still going on from '82.

17 CHAIRMAN MENDEZ: Yes.

18 MR. THIMELL: As Mr. Williams previously stated,
19 it is not the intent of the corporation to abrogate any current
20 legal obligations with this provision. It is, in fact, pros-
21 pective in its application in that no such approvals will
22 be made or there's no new such instances are going to be
23 allowed; however, if, in fact, there is legal obligation
24 that we're under, we don't intend to abrogate that with this
25 provision.

1 MR. SIMPSON: However, I would note that to the
2 degree continuing representation is now being done from '82
3 and before funds for aliens now not eligible within weeks
4 of this provision becoming prospectively active, there will
5 be no such funds, and you will be right back into their losses.

6 MR. COSTER: And, that -- for that reason, the
7 corporation reluctantly but necessarily is not applying this
8 provision to its own backlog of those funds as we discussed
9 earlier. We are making provisions in trying to ascertain
10 how many of those cases, how many dollars, and what programs
11 they're managing. Until we have that information, we can't
12 address it on an exact dollar basis, but certainly we keep
13 the log.

14 MR. SIMPSON: It is a strange construction of our
15 rule that makes the corporation the guarantor of the ethical
16 responsibilities of programs and takes away their own ability
17 to do so.

18 MR. COSTER: But, it is an ethical responsibility.

19 CHAIRMAN MENDEZ: Speaking of that, I will agree
20 it's a strange provision, but the statute says that we have
21 to pay for all bills for attorneys fees, that they are not
22 meritorious and not the local programs. That's the flip of
23 what this is. So, I can understand what you're saying, but
24 I can also see the statutory provided for that.

25 MR. SIMPSON: That's an interesting point.

1 MS. BERNSTEIN: Let me just ask, though. If Congress
2 should decide at some point that an alegal problem or a potential
3 class of client would no longer be served with Legal Services
4 appropriated money, unless it were determined that there
5 was a reason, the FIFO -- I mean, that's the situation that
6 we're in and having appropriations each year with Congress
7 making authorizations, making riders each year, and we can't
8 presume that Congress intends for us to continue taking cases
9 or continue expending money on areas that they have now
10 determined we should not be dealing with.

11 CHAIRMAN MENDEZ: Well, I understand what you're
12 saying. I'm just going to reiterate that I'm going to be
13 gone at four o'clock.

14 MS. BERNSTEIN: That's okay. I'm simply saying,
15 though, I don't -- what I heard said, and I'm not sure I
16 agree with what Joel said, is that we will be extending a
17 legal representation.

18 MR. THIMELL: I think what I said was we were not
19 going to abrogate any legal obligations that we currently
20 have, if, in fact, we are legally obligated under some settle-
21 ment or some other arrangement to provide money. We're not
22 going to break that obligation. I did not state quite as
23 much as Mike might have said that, in fact, we are prospectively
24 going to supply funds, to continue doing things that Congress
25 has since said should not be done.

1 CHAIRMAN MENDEZ: We understand.

2 MS. BERNSTEIN: Okay.

3 MR. SIMPSON: The next item was referred to this
4 morning, that's the provision in 2-1.92 on cost reimburseable
5 grants. These are relatively infrequent grants, certainly
6 in the current operation of the corporation with regards
7 to recipients, but they do happen.

8 What's involved here is that the provisions state
9 that if you give me a \$5,000 grant to do something on a cost
10 reimburseable basis, that is, I submit the bill and you pay
11 me back, and it costs me \$5,500, that before I can use my
12 own basic field grant for the extra \$500, I have to obtain
13 approval.

14 On some levels, that's not a big problem, but on
15 operating levels, it strikes me that it is a problem because
16 you're going to be at the \$4,000 spent point, maybe in the
17 middle of an event or in the middle of a project, when you
18 realize you're going to run a little over and that you're
19 going to have to use some of your own money.

20 Approvals take time, and the standard here, which
21 is that the corporation will look into the matter and determine
22 whether the basic field program is putting up the extra \$500
23 is adversely affected, is a fairly broad and uncertain one.

24 In addition, of course, if there's anything really
25 wrong with the expenditure, it's going to be ineligible anyway

1 under the question of cost regulation, as unnecessary,
2 unreasonable, excessive or whatever or illegal, if it were
3 illegal or an improper purpose of a program, proper and legal
4 assistance activity under a grant.

5 So, what we really have here is a situation in
6 which, for some reason, the corporation wants the power to
7 decide whether it's going to adversely affect the program
8 when a program is using its money in a necessary, reasonable,
9 non-excessive and legal fashion, and to put a possible bind
10 on a program that's in the middle of the activity under the
11 cost reimburseable grant.

12 I would just suggest that here, as in the indirect
13 cost area, where the change was made, you have a regulation
14 that gives you full control for anything that's not appropriate.
15 There's no need for a special approval process in the small
16 number of cases, certainly not any great practical need.

17 MR. THIMELL: I think the problem here is the
18 corporation wants to be able to say that if we give you money
19 for very specific purpose, for a very specific limit, that
20 you're going to live within that limit and not simply draw
21 down your basic field grant to extend that activity to any
22 level that you think is appropriate.

23 We give grants for very mixed purposes, to a wide
24 variety of programs, and one program that, in fact, provides
25 eighty-six services directly to clients may be providing

1 computer-assisted legal research to a bunch of other programs,
2 and we may have put a ceiling on that. And, I think we're
3 saying that if, in this particular instance, we have given
4 you that money, we don't want you to double the computer
5 project at the expense of your client. We want to know.

6 I don't think that the \$500 case is going to be
7 a problem, but I think you've got to know when you get that
8 check or you get that notice up front that \$5,000, you've
9 got to plan for it to be \$5,000 and not \$5,500.

10 MR. SIMPSON: First, of course, you don't get a
11 check up front under the cost reimbursable contract.

12 MR. THIMELL: You get a notice.

13 MR. SIMPSON: Of the contract. Second, if you
14 want to say in the contract that you can't use any basic
15 field funds beyond the amount in the contract, they have
16 the contract. There's no need for an approval process after
17 the fact. If you want to stiff the program, stiff the program.

18 MR. WALLACE: You know, I can see why you want
19 to tell people to stay within their limits, but if you do
20 put it in the contract and say don't use any more money, turn
21 off the switch, when you hit \$5,000, --

22 MR. THIMELL: This is simply, you know, one place
23 to catch all places as opposed to going through each
24 instance and making sure you've crossed all those t's and
25 i's, and you're putting them on notice that we're not doing

1 that sort of thing.

2 MS. BERNSTEIN: I personally don't see the problem.
3 I mean, it seems to me that if you -- that you call for good
4 planning.

5 MR. WALLACE: Well, let me say this then. There
6 doesn't seem to be majority sentiment of the committee or
7 maybe any sentiment of the committee to change this, but
8 I think what we said in my committee this morning is probably
9 the case; that this is something that's got -- you've got
10 to get prior approval on, and we've got to get some language
11 to get it into that regulation.

12 So, on the long list of things that are remaining
13 to be done, we need something or other --

14 MR. SIMPSON: I would note as a planning matter,
15 of course, that you're making a contract, the planners of
16 the corporation would be efficient planners if they included
17 a clause where appropriate where they didn't want an overrun
18 to go the basic field, just say so. That's the program planning
19 issue. Maybe that's what you meant. I'm not sure which
20 way you were going.

21 MS. BERNSTEIN: Well, I'm not saying it should
22 be done that way, but I agree that the problem in terms of
23 the attorney is that if a specific fund was given for a specific
24 reason, then if it goes beyond that fund to another fund,
25 then that's when we start looking at it. That can happen.

1 MR. SIMPSON: That's the point. Certainly, it
2 can.

3 MS. BERNSTEIN: I mean that what you've got to
4 do, you know, with all good faith on everybody's part was
5 there, and the approval process in terms of going beyond
6 there simply allows for an agreement that it is an appropriate
7 expenditure of the fund prior to determining the extent.

8 MR. SIMPSON: Sure. But all I'm really saying
9 on the ineligible point is if you allow a program to spend
10 a million dollars, if you give them their basic field grant,
11 it seems silly to say that they can't make the judgment of
12 \$500, about whether it's proper or not, on the overrun on
13 a cost reimbursable contract, and if they're wrong, it's
14 going to be an ineligible cost.

15 Well, this is not a point worth spending more time
16 on here. We'll talk about it in the question of cost record.

17 MR. WALLACE: Looks that way.

18 MR. SIMPSON: It goes both ways.

19 I want simply to note a legal question. I'm fairly
20 sure the staff hasn't had a chance to work on it. The provision
21 in 2-1.13 for the first time in the provisions two weeks
22 ago subjects interest income --

23 MR. DURANT: What's the section again?

24 MR. SIMPSON: 2-1.13.

25 MR. DURANT: Okay.

1 MR. SIMPSON: On page 19.

2 It subjects interest income to the restrictions
3 in the current year appropriation not just to the restrictions
4 in the fund from which the interest was earned, which would
5 be maybe the same year, maybe the prior year's appropriation.

6 And, I think it's simply a legal question, whether
7 under appropriations act, which, by their terms, limit their
8 application to the funds provided under the Act, it's an
9 appropriate or lawful action to apply the restrictions against
10 another year.

11 I raise the question. I don't wish to pursue
12 it today because of time. If the corporation staff examines
13 it, concludes that there's a legal problem, then we should
14 take it back out.

15 MR. COSTER: We have and we haven't.

16 MR. SIMPSON: Okay. Obviously, on many of these
17 legal issues, as happens and somebody doesn't like what happens,
18 we know where we end up talking about it.

19 MR. WALLACE: Sure.

20 MR. COSTER: The intent of the staff in the one
21 sentence was to bring our treatment of investment income
22 for prior years funds into line with general grant making
23 laws as prescribed by the Federal Government, and that seems
24 that this is the way to do it, and that we were pretty much
25 an aberration, and I would point out as a monitor, when you

1 go into a program and particularly a desized program and
2 they start, you know, the circus routine of juggling 1981-
3 1982-1983-1984 funds, it's damn difficult, and I think, in
4 some cases, it's been intentional to objicate the matter.

5 CHAIRMAN MENDEZ: All right. Next issue.

6 MR. SIMPSON: Page 26, item 11, the fundamental
7 financial criteria which are the side-wide pages here, have
8 always, in the past, since they were created, contained a
9 third column on the right, called risks, which was an attempt
10 at lay language to describe what the stuff on the left was
11 about, and why a board member, a lay person, somebody who
12 wasn't a financial manager, should be concerned.

13 What we have done in this draft, and it was not
14 done in the draft before, is delete all of the right hand
15 column. The normal person's explanation of why do I worry
16 about this stuff.

17 Now, Mike told me, when we met, that there was
18 a problem, and the problem was that there were some more
19 risks that weren't in the right hand column. I can believe
20 that, but if there is, we ought to put them there, but this
21 is the closest we're going to come to something that
22 communicates to board members, non-financial managers, in
23 an effecive way about what the basic internal control issues
24 are. We ought to keep the risks in there.

25 CHAIRMAN MENDEZ: Mike?

1 MR. COSTER: Without consenting to represent the
2 abnormal, we intentionally took the risks out. We found
3 them, again, briefly, to be a very -- to be lacking comprehensibly
4 We didn't address all the risks that could come out of the
5 concerns which are expressed generally on the right side
6 pertaining that to the left side because they weren't
7 comprehensible, and we don't want to lead a program manager
8 or his employees, or her employees, or an auditor, into thinking
9 that if the risks on the left most column, the risk column,
10 were covered, that, in fact, all of the needs of that particular
11 section were served.

12 MR. DURANT: Couldn't you have said that at the
13 top of the column?

14 MR. COSTER: Well, we thought about doing that.
15 We also made the determination that evidences itself in other
16 places in the audit guide -- the audit guide is not intended
17 to be an intermediate accounting book or principles of accounting
18 book, and in that there are other guidelines, other technical
19 references, it is information available from the
20 corporation, it seemed that the disadvantages of having those
21 risks there outweighed the fact that they provided ready
22 reference to lesser trained or worst bookkeepers in a program.

23 MR. DURANT: What was the greater risk?

24 MR. COSTER: The greater risk being that the listed
25 risks were not comprehensive, that it may have specified

1 one of the principal ways in which that internal control
2 failure might evidence itself, but it overlooked many that
3 an average young accountant would know about.

4 I don't think that we wanted to --

5 MR. DURANT: Do you have a copy of one with the
6 risks in it?

7 MR. COSTER: Yes, I believe I do.

8 MR. WALLACE: Color-coded orange.

9 MR. DURANT: I don't have any other questions
10 on that at this time.

11 MR. WALLACE: Yes. I would just say -- I mean,
12 my gut feeling is that it would be -- if something is
13 incomplete, make it more complete, don't take it out, but
14 I'm not enough of an accountant to pass judgment on that.
15 So, I won't --

16 MR. DURANT: I'm enough of an accountant.

17 MR. COSTER: If that should be the committee's
18 decision, that would be done.

19 CHAIRMAN MENDEZ: My own belief on this is that
20 this is an audit and accounting guide for auditors, accountants,
21 and those who have particular skills in this area, and if
22 somebody is playing around with it and looks under the risks
23 and -- I tend to agree with that.

24 MS. BERNSTEIN: I was going to say not only that,
25 but it seems to me that this is one of the situations

1 in which the auditor of the program can translate. They
2 are used to translating for non-profits, you know.

3 MR. SIMPSON: I wish I thought that auditors were
4 better than lawyers in making audit concepts clear to boards
5 of directors as lawyers try to make legal concepts clear
6 to boards of directors. I think language sometimes gets
7 in the way.

8 There are a third of the members of boards of directors
9 who are clients that have clear fiscal responsibility. They
10 are fiduciaries, but they are, in many cases, not legally
11 trained or financially trained, and this audit guide is a
12 clear responsibility on them, and I think the language that
13 might speak best for those with the least skills, but the
14 great responsibilities should be left in.

15 MS. BERNSTEIN: There's a lot of legal and financial
16 requirements that are on the programs, and, you know, we
17 can't explain all of it beyond the explanations in the rules
18 themselves.

19 CHAIRMAN MENDEZ: All right. Larain would like
20 to have it back in, and I think, Hortense, would you agree
21 that you would like to have them back in, if it makes it
22 a little bit easier to read?

23 MS. BENAVIDEZ: Yes.

24 CHAIRMAN MENDEZ: Okay. We'll put them back in.

25 MR. COSTER: We'd ask only that we change the title

1 and make any other appropriate notations to that.

2 CHAIRMAN MENDEZ: And, to show that it's not an
3 all inclusive and it's not intended to be, that it's a layman's
4 version.

5 MR. SIMPSON: The last problem is a very straightforward
6 one. In two places in the fundamental criteria, it deals
7 with what happens in programs when the mail received and
8 the cash comes into the office. In each case, the appropriate
9 internal control is there. Somebody who doesn't handle the
10 books, opens the mail, and somebody who doesn't handle the
11 books, takes the cash. The reason is so that two people
12 know about it instead of one.

13 MR. COSTER: Let me save a moment. We overlooked
14 that. We're agreeing to that, using somewhat strong language
15 than was suggested, and we would -- have you properly located
16 those for the record?

17 MR. SIMPSON: It's in 3-4.4, and I don't have the
18 page number.

19 CHAIRMAN MENDEZ: It will be found.

20 MR. THIMELL: Page 41, mail. It says the mail
21 should be opened by a person with no other bookkeeping
22 experience and also the one above speaking about non-accounting
23 individuals should be assigned to receive the cash receipts,
24 and we are suggesting to put in the clause following each
25 of those phrases, unless impossible.

1 MR. COSTER: Comma, unless impossible.

2 MR. SIMPSON: That should work.

3 CHAIRMAN MENDEZ: All right.

4 MR. SIMPSON: Just so the auditor knows it's not
5 an absolute.

6 CHAIRMAN MENDEZ: All right. Now, before we turn
7 to other issues, this gentleman in the back had a comment,
8 and we're going to let him have two minutes.

9 Please come forward.

10 MR. VASALY: I have -- my name is Chuck Vasaly.
11 I'm the project director for Legal Services of Northern
12 Virginia.

13 I haven't had the opportunity to see all of Gerry's
14 report, and I know you were getting into the question earlier,
15 I took a note, dealing with the auditor selection issue,
16 and I just wanted to add one item of possible concern in
17 that area.

18 I can understand the staff's zealously towards
19 the stewardship of the monies that the corporation is accountable
20 to to Congress. But, I think going that one more step, it's
21 probably an unnecessary step because I think you already
22 exercise considerable power in the area of rejecting audits,
23 requiring other individuals to do audits, the exclusionary
24 power, and I speak of personal experience here, since you
25 folks not too long ago asked us to fire our auditor, even

1 though we did, I guess, fairly well in the fundamental criteria
2 review in terms of the internal controls. You felt very
3 unhappy when you went to our auditor's office and looked
4 over the -- his worksheets and whatever auditors are supposed
5 to have in their office.

6 Nevertheless, you exercised that power. My board
7 was concerned. I was concerned, but we decided to, rather
8 than fight it, to abide with the decision and we went after
9 the auditor solicitation bid process, got a new auditor,
10 who will cost us \$4,000 more, but we feel that perhaps it's
11 a Big "8" firm and we will have the necessary protection
12 in terms of what that auditor keeps in his records.

13 To go the one step beyond that and without cause,
14 say to a program, we're going to appoint this particular
15 auditor to you, without perhaps justifying the reasons for
16 that, certainly it doesn't help the program from an internal
17 management point of view.

18 What is wrong with our existing auditor? Our existing
19 accounting systems. The preclusion requirement, as I understand
20 it, you still have to give reasons which will help a program
21 in terms of its internal management. Its accounting
22 requirements. You won't help a program simply by saying
23 we don't like that auditor, you take this one.

24 One final thing on that. A lot of programs have
25 other funding sources, and while I sometimes wonder if we

1 still operate as independent corporations accountable to
2 the state charter and so on, I think we're set up that way
3 initially, and we have to be accountable to the funds that
4 those other funding sources provide, and consistently, there
5 is a requirement to have an independent auditor to do a report
6 and submit it back to the funding source.

7 Now, arguably, perhaps, through whatever contractual
8 arrangements the corporation might engage another auditor
9 to do an audit for a program, an auditor selected by the
10 corporation, it may to the corporation appear to maintain
11 that independent audit status.

12 I have serious doubts as to whether our other funding
13 sources, considered your auditor, should affect us, would
14 be our auditor, to be independent, and we would, in effect,
15 be forced to probably have our own independent auditor in
16 order to satisfy those other funding sources.

17 I think there's severe extra costs associated with
18 this, and I think the point has already been raised, there
19 are occasions when a program wants to talk to an auditor
20 about issues, not to hide things, not to duck requirements,
21 simply to get in interpretations of them.

22 You do that through an independent auditor, you
23 don't necessarily do that through an auditor that's working
24 for the corporation.

25 CHAIRMAN MENDEZ: Thank you very much, Chuck.

1 Gerry, let's turn your attention to functional
2 accounting now.

3 MR. SIMPSON: Okay. Let me turn your attention
4 to page 13 of my memorandum.

5 CHAIRMAN MENDEZ: Let's -- what page?

6 MR. SIMPSON: 13.

7 CHAIRMAN MENDEZ: All right. After we address
8 page 13, I will want to have Mike come address us with regard
9 to Appendix 6.

10 MR. SIMPSON: Okay. I would note --

11 CHAIRMAN MENDEZ: Page 13.

12 MR. SIMPSON: Page 13 of my memorandum, dated
13 October 24th, I would note in the preface that, of course,
14 Appendix 6, having arrived here this afternoon, is not something
15 any of us have examined. It does deal with functional account-
16 ing, and the part and parcel of this discussion, but its
17 language is new or partly new.

18 I'm not going to repeat what is said in my memo
19 from about page 5 to page 12, which is the background and
20 some discussion about the functional accounting issue.

21 Essentially, what it says is that there are five
22 or six very fundamental questions about functional accounting
23 and what it will be and what it will cost and what benefits
24 it will produce, what programs have the experience now and
25 what we can learn from it, what other non-profit service

1 organizations have the experience now, and what we can learn
2 from it, and the field programs and the project advisory
3 group, which I represent here today, are interested in working
4 with the corporation, so that there's an orderly transition
5 to whatever new system is going to be in place.

6 CHAIRMAN MENDEZ: Could I just ask you a couple
7 of questions with regard to functional accounting?

8 MR. SIMPSON: Yes.

9 CHAIRMAN MENDEZ: Do you think under functional
10 accounting, we ought to break out PAI?

11 MR. SIMPSON: I think that PAI should be dealt
12 with as a function. I think so for two reasons. One, it
13 is a function, particularly with the board emphasis on it;
14 and, two, because trying to distribute, particularly in pro
15 bono programs or sub-grantee programs, the functional nature
16 of activity is going to be very difficult.

17 CHAIRMAN MENDEZ: All right. What about lobbying?

18 MR. SIMPSON: I think lobbying and training, which
19 is another aspect of the staff proposal, both are not
20 functional categories in the traditional sense at all, that
21 they are, in fact, spread across the substantive areas of
22 a program's operation, and need to be reported that way.

23 CHAIRMAN MENDEZ: But, in view of the congressional
24 interest, don't you think that's an important issue?

25 MR. SIMPSON: I will make no friends with what

1 I'm about to say. They heard it a couple of days ago.

2 If you need a full costed account for lobbying
3 or training, then you need something different than a functional
4 report. You need either to treat it as a natural item of
5 classification but then you're going to have sub-headings
6 for salary and so forth as well as just the direct costs
7 or you need another schedule.

8 I will be shot.

9 CHAIRMAN MENDEZ: What about fund raising? Do
10 you think fund raising --

11 MR. SIMPSON: Fund raising is a functional category
12 as is administrative and general.

13 CHAIRMAN MENDEZ: When you talk about administrative,
14 you're talking about management administration?

15 MR. SIMPSON: Yes. Non-case related work.

16 CHAIRMAN MENDEZ: What do you call priorities or
17 case-related work?

18 MR. SIMPSON: It's clear in a functional statement
19 in a program of any size. I'm not sure what smallness would
20 count, but you need some breakout of program services at
21 a greater level of detail than just program services.

22 Whether the priorities are effective for this or
23 whether cost sensors and specialty units are a better guide
24 or a better tool are not clear.

25 CHAIRMAN MENDEZ: Specialty unit really is a priority.

1 MR. SIMPSON: But its location-based.

2 CHAIRMAN MENDEZ: but it's still -- I mean, it's
3 still a function.

4 MR. SIMPSON: Absolutely. Oh, no. Please don't
5 misunderstand me. Breaking it out by the priorities may
6 be entirely appropriate. Breaking it out by units may be
7 entirely appropriate. That's really a question that needs
8 to be determined probably by examining the operations of
9 the program and picking the way that will be most effective
10 for disclosure.

11 CHAIRMAN MENDEZ: Now, you've got to come back
12 here. I'm going to be educated, but you've got to come back
13 and educate me why lobbying shouldn't be functional.

14 MR. SIMPSON: Because if a program is doing lobbying,
15 it's doing lobbying on housing, on welfare, on consumer,
16 on health, on education, who knows, but if you want to know
17 what it's costing to housing, welfare, education, consumer,
18 you've got to have the lobbying expenses in there in the
19 column that deals with that, and if you've got the lobbying
20 expenses over here, then you haven't got a complete statement
21 of functional costs.

22 You've got an incomplete disclosure of the functional
23 costs.

24 MR. WALLACE: You want to know everything, you've
25 got to cross the bridge.

1 MR. SIMPSON: That's correct. You've got to do
2 it by suggest matter and also by available tools.

3 CHAIRMAN MENDEZ: Okay. Do you think that's
4 appropriate for us to do?

5 MR. SIMPSON: My problems go deeper. My problems
6 go to the fact that none of us know. We need to find out
7 what the costs and benefits really are. It may be very
8 appropriate. It may provide very useful information. Let's
9 take a look at that, find out what it's going to provide.

10 MR. DURANT: Pepe, let me ask you a question about
11 that. You know, Tom Speigal, who couldn't appear, but I
12 thought he made a fairly astute comment in New Hampshire
13 when he said that one of the reasons he was supporting
14 functional accounting is that I think, you know, sometimes
15 one may think there's the tension between some of the
16 witnesses and some of the board and a variety of things that
17 we may or may not be doing or whatever.

18 But I think there is a common purpose, I believe,
19 in that really, in our own way, each of us are honestly trying
20 to find out what is going on on a day-to-day basis because
21 I know in my business that I've had, you know, that if they
22 had been, frankly, good business -- I've seen some good work
23 being done. I've talked to some good people in the work
24 that they're doing, but I think Tom's point was, is that
25 how best on a systematic way -- basis, can we know if time

1 is being well spent. I think that's why the impetus on time
2 sheets and whatever. I know, when we sit down in our partnership
3 meetings, we're a small part, we rate each other internally
4 because we are spending too much time on politics, we're
5 spending too much time on this or you're not spending enough
6 time on whatever, whatever.

7 It seems to me that this kind of detail that we're
8 really trying to seek really is based in providing that kind
9 of information so that we can then make a common judgment
10 about what has to be done.

11 Do you agree with that?

12 MR. SIMPSON: I do agree with that. The way that
13 I would respond is to say that we don't know enough about
14 what information will actually inform us. We haven't got
15 the staff work done. The field hasn't got the work done
16 either. This is not an issue that we said let's go and find
17 out.

18 There are others who know much more than we do.
19 People in the field programs who, in fact, are doing it or
20 much more of it, people in other non-profits who do it.
21 Obviously, there are accounting firms that have knowledge
22 and perspective on this, so that the closer we are to real
23 data the better we are.

24 One of the anxieties I have is that we will invest
25 a great deal of money and get to a place a year and a half

1 from now when we've got to set a financial report and we
2 will be very disappointed because we will not know much more
3 about what's going on.

4 I think we'd better know before we spend what is
5 variously estimated as \$20 million or \$15 million, I think,
6 a low figure is 10, which is more than we spent on national
7 support, more than we spent on state support, more than we
8 spent on migrants, more than we spent on Native Americans.

9 We don't want to make a quick judgment on some
10 issue like this and spend more money than we want for any
11 of those delivery systems in the years to come.

12 MR. DURANT: Yeah, but let me --

13 MR. SIMPSON: You've got a plane to catch.

14 CHAIRMAN MENDEZ: Yeah.

15 MR. SIMPSON: Do public relations later, the chairman
16 has got a plane to catch.

17 MR. DURANT: All right.

18 CHAIRMAN MENDEZ: You can ask one question.

19 MR. DURANT: Okay.

20 MS. BERNSTEIN: Actually, I just wanted to point
21 out that, Gerry, you wrote a paper called "Accounting Under
22 the New Twelve and a Half Percent Private Attorney Involvement
23 Regulations". Actually, this is a follow-up to what Clark
24 just said because you told the programs at that time that
25 attempts should be made to assess whether the direct/indirect

1 costs of running a PAI would be higher per comparable case
2 than an existing approach.

3 MR. SIMPSON: Absolutely.

4 MS. BERNSTEIN: Is that impossible to do without
5 functional accounting?

6 MR. SIMPSON: No, I disagree with that, but, I
7 mean, please, understand me. I said this last time.
8 I am not an opponent of functional accounting, and I'm an
9 advocate for better recordkeeping and as a consultant to
10 a couple programs, I have recommended better time systems
11 to a lot of them on PAI.

12 MS. BERNSTEIN: Okay. I just --

13 MR. SIMPSON: We're not disagreeing about that.
14 The question is how much money we're going to spend and is
15 it going to really tell us what we think is useful enough
16 to know to spend that much.

17 CHAIRMAN MENDEZ: Now, here's what we're going
18 to do. We're going to put a motion on the table. We're
19 going to allocate four minutes for you to make any discussion
20 that you want to on the motion, and four minutes to you guys
21 to figure out what you want to say, and then we're going
22 to vote on it, because I'm going to be out of here.

23 MR. DURANT: Don't want to lose the quorum.

24 MS. BERNSTEIN: Well, I would move that the
25 corporation adopt the audit and accounting guide as modified.

1 Obviously, we're moving that the committee recommend to the
2 corporation that it be adopted, and as a final form, the
3 cleaned up version implementing the changes that we discussed
4 today be delivered to the board in California for final
5 adoption.

6 MR. THIMELL: Question of clarification. Do you
7 want this committee to see that cleaned up version in
8 California before it finally goes to the board? Is this
9 committee going to meet in California?

10 CHAIRMAN MENDEZ: This committee will meet in
11 California for a torture session.

12 MR. WALLACE: So I understand. Will this be part
13 of it? I mean, do we want to see the final draft from the
14 staff before it goes to the board?

15 CHAIRMAN MENDEZ: What is the pleasure of the --

16 MR. WALLACE: I'm going to be trying a lawsuit,
17 so --

18 MS. BERNSTEIN: My motion assumed that there were
19 no substantive changes, other than the ones we've discussed
20 today, and that the changed -- the cleaned up version would
21 be a technically clean version. I mean, I'm not --

22 CHAIRMAN MENDEZ: And, we will allow comments
23 to the board before --

24 MR. WALLACE: I assume, Mr. Chairman, would that
25 be a fair statement?

1 MS. BERNSTEIN: I presume that the committee --

2 MR. THIMELL: Do you want to propose the new
3 language for Appendix 6 in that version as well, deal with
4 it separately? We haven't really --

5 MR. DURANT: Mr. Chairman, I think we ought to
6 take it up at the meeting. I think we can pass on it today,
7 which we need to do. I think maybe Mr. Wallace may be right,
8 that --

9 CHAIRMAN MENDEZ: Okay. Why don't we do it that
10 way? We'll pass on it today, and then we'll have further
11 discussion on it, the cleaned up version, especially with
12 regard to Appendix 6.

13 MR. DURANT: You're going to add the risks back
14 into it.

15 MR. WALLACE: Did you decide that?

16 MR. THIMELL: Yes.

17 MR. WALLACE: Okay. I'm sorry. I must have been
18 on the phone.

19 MS. BERNSTEIN: You want to second the motion?

20 MR. WALLACE: Oh, okay. I'll second that.

21 MR. SIMPSON: If I understand the motion then,
22 the committee will meet, I suppose, on Thursday, and discuss
23 and conclude and pass along to the board for Friday adoption
24 of the guide.

25 CHAIRMAN MENDEZ: A cleaned guide and I've asked them,

1 as soon as possible, to get you a cleaned up version.

2 MR. SIMPSON: Thank you.

3 CHAIRMAN MENDEZ: They told me that they will have
4 you the cleaned version at the same time they have it to
5 us.

6 MR. SIMPSON: Okay. I promise not to write another
7 26 or 27 pages either. This is about it.

8 MR. DURANT: The last time.

9 MR. SIMPSON: Do I assume, and I'd like to ask
10 if not so, that the last paragraph of Mr. Thimell's memo
11 on page 3, which proposes the method by which the guide
12 once implemented goes into effect, will be the manner that --
13 the style of the motion when it's made to you? That is --

14 MR. DURANT: The last paragraph on this page 3?

15 MR. SIMPSON: Yes. That it will be mailed to field
16 programs with a thirty day notice.

17 MR. WALLACE: I want -- I didn't understand that
18 to be the motion, and I'd really like -- that's something
19 that I think requires some legal thinking. I mean, I have
20 not looked at the section --

21 CHAIRMAN MENDEZ: All the motion is -- we understand
22 your question.

23 MR. SIMPSON: I have no objection to it going forward
24 to the committee meeting two weeks from now.

25 CHAIRMAN MENDEZ: All right. Let me read the motion

1 again.

2 Move that the corporation adopt the audit and accountin
3 guide as modified, the final form to be delivered to the
4 board in California, and that would be what -- how do we
5 want to address in terms of comment, how do we want to address
6 article --

7 MR. WALLACE: Appendix 6.

8 CHAIRMAN MENDEZ: Yes.

9 MR. WALLACE: We haven't done it well.

10 CHAIRMAN MENDEZ: But this is conversation.

11 MR. WALLACE: Yeah. I kind of think that
12 the staff has got instructions pretty clearly, I think, on
13 everything but Appendix 6, and when we hit ground Thursday
14 in California, I don't see how Appendix 6 is going to be
15 much changed from what we've got it here. You've got new
16 ideas to give us, fine. We just are going to have to deal
17 with it when we get there or adopt it as.

18 CHAIRMAN MENDEZ: All right. Again, let me just
19 see if I can -- just in terms of conversation -- excuse me.
20 In terms of discussion.

21 If we adopt all of this, including Appendix 6,
22 and allow -- and if Mr. Durant will make an assertion on
23 the record that he will allow at least some discussion about
24 Appendix 6 in California --

25 MR. DURANT: Well, it's going to come to your

1 committee first.

2 CHAIRMAN MENDEZ: No. We're just going to send
3 it straight through to the board on the motion.

4 MR. WALLACE: I misunderstood. I thought we'd
5 decided that -- well, I told you I was getting --

6 CHAIRMAN MENDEZ: As the motion stands --

7 MS. BERNSTEIN: That we forward it to the board.

8 MR. SIMPSON: Then, I need to withdraw what I said
9 a minute ago because I understood Mr. Wallace to be --

10 CHAIRMAN MENDEZ: Is there an amendment to her
11 motion?

12 MR. WALLACE: I'd like to make an amendment that --
13 I don't know whether you'd consider it friendly or not.

14 MS. BERNSTEIN: I don't know whether I even have
15 a second.

16 MR. WALLACE: I seconded it, and I won't withdraw
17 it, but I'll let Clark move his motion. I may do that, too.

18 MR. DURANT: My amendment is that it be with the --
19 that it would be forwarded to your committee and would stay
20 in your committee. We would approve what we have now and
21 it would come to your committee to look at the version that's
22 going to be fixed up with the technical changes, adding the
23 risks, and it will address Appendix 6.

24 CHAIRMAN MENDEZ: But in terms of discussion, will
25 we reexamine for approval, or is it approved as corrected

1 and if there's any amendments, or are we going to -- do you
2 want us to be allowed to have amendments at that time?

3 MS. BERNSTEIN: Could I withdraw my motion and
4 make another motion?

5 MR. DURANT: I'll withdraw my attempt to amend.

6 MR. WALLACE: And, I'll withdraw my second and
7 start over.

8 MS. BERNSTEIN: I move that this committee recommend
9 the adoption of the audit and accounting guide, except for
10 Appendix 6, and to be voted on by the entire board. The
11 final form cleaned up to be delivered to the board in
12 California.

13 As the second part of that motion, I move that
14 this committee examine Appendix 6 and make a recommendation
15 regarding Appendix 6 at that time.

16 MR. DURANT: I'll second that.

17 MR. WALLACE: What a concensus motion.

18 CHAIRMAN MENDEZ: Would you consider distributing
19 Appendix 6, as you understand it to be, to the field to have
20 some comments? I would remind you if the audit guide had
21 been out there for comment, everything else has been out
22 there, that --

23 MS. BERNSTEIN: You know, we've got --

24 CHAIRMAN MENDEZ: Monday or Tuesday, something
25 like that.

1 MR. SIMPSON: Clarification. The earlier discussion
2 about technical amendment, cleaning up all of this is to
3 the part of whatever the staff presents as adopted?

4 CHAIRMAN MENDEZ: Yes, that's correct.

5 MR. SIMPSON: Today's very rapid discussion of
6 the substantive issues where we only raise them, but didn't
7 have a chance to really explore them with the time pressure,
8 those that were not responded to with changes are not to
9 be included, is that correct?

10 MR. WALLACE: Right.

11 MR. DURANT: You didn't get a nibble the first
12 time. It can be something the whole board can talk about.

13 CHAIRMAN MENDEZ: Gerry, what I would like to do,
14 too, so that you have every opportunity, I would like you
15 to mail a copy to the members of the board.

16 MR. SIMPSON: Could I ask that the staff, which
17 has copies of it, do that for me?

18 MR. THIMELL: Yes.

19 MR. SIMPSON: Fine.

20 MR. DURANT: Do they -- do the other members of
21 the board have all -- I mean, all the memos that you want
22 or just --

23 MR. SIMPSON: The packet that was presented to
24 you with the three appendices was the whole package.

25 MR. DURANT: Okay. Thank you.

1 MS. BERNSTEIN: I have a motion now. Did somebody
2 second it?

3 MR. DURANT: I seconded it.

4 CHAIRMAN MENDEZ: Has to be voted on.

5 All in favor, say aye.

6 (Chorus of Ayes.)

7 CHAIRMAN MENDEZ: Opposed? (No response)

8 For the record, it's unanimous.

9 All right. And, you have --

10 MR. SIMPSON: I have the draft, yes.

11 May I ask one other question?

12 CHAIRMAN MENDEZ: Please.

13 MR. SIMPSON: Obviously, the manner of implementation
14 the way in which we're going ahead on functional accounting,
15 it's going to be very important, if the staff is going to
16 have a motion or a plan, I hope we'll get some idea of what
17 it is.

18 CHAIRMAN MENDEZ: What I would ask the staff is
19 to at some time in the fairly near future meet with Mr.
20 Simpson, get all of his ideas about implementation.

21 MR. SIMPSON: I had proposed on pages 13 and 14
22 of my memorandum a specific set of matters which would lead
23 to a report to this board regarding implementation. I'd
24 like to know whether the staff intends to do anything that
25 resembles that in terms of a study of issues leading to a

1 report to this board prior to formal implementation. That's
2 the most fundamental issue.

3 MR. COSTER: I think we have that, too. Let me
4 make sure I'm speaking to the right thing. I think --

5 MR. THIMELL: We haven't had time to study this
6 whole plan and decide whether --

7 CHAIRMAN MENDEZ: They're operating under the same
8 burdens that you operated under.

9 MR. SIMPSON: yeah, except I described all the
10 points to them on this Wednesday. So, it's not brand new
11 material.

12 MS. BERNSTEIN: They spent yesterday getting ready
13 for today.

14 CHAIRMAN MENDEZ: Let me --

15 MR. DURANT: Let me just ask -- well, I'll wait.
16 Go ahead.

17 CHAIRMAN MENDEZ: What we will do is we will address
18 this issue -- I suppose it has to be California. What we'll
19 do is we'll do this issue in California. The last thing
20 on the agenda.

21 MR. DURANT: Can I ask Gerry, when we -- when you
22 were asked in New Hampshire for -- and I'm glad that you
23 did, for the additional time for comments, my understanding
24 and perhaps this is something that I'm not aware of, the
25 transmission of information and the meetings that have been

1 taking place immediately, it's my understanding that they
2 did not -- why is that so?

3 MR. SIMPSON: I can tell you from my end and, first,
4 I would -- I'm not sure I said immediately. I had to read
5 it, first. I had to find out what was in it. I left New
6 Hampshire on Friday afternoon at one, went to Boston, picked
7 up my daughter and took her to New York for the weekend,
8 as I had promised to do.

9 So, it was Monday before I began to be able to
10 look at it. I looked at it on Friday. I had an extensive
11 conversation with Mr. Coster in which I raised all the
12 substantive areas --

13 MR. DURANT: On Monday?

14 MR. SIMPSON: Friday.

15 MR. DURANT: In New Hampshire?

16 MR. SIMPSON: No. Friday a week from New Hampshire.

17 MR. DURANT: Okay.

18 MR. SIMPSON: I talked to Mr. Williams on Thursday,
19 and he had indicated to me I should talk to Mr. Coster. I
20 talked to Mr. Coster, and named all the issues that are in
21 the substantive part of this memorandum. Obviously, not
22 with a great detail that you have on functional, and I had
23 teaching obligations Monday and Tuesday. Mr. Williams wanted
24 very much if I could come Monday and Tuesday. I was unable
25 to do that. I express mailed the October 20 letter for receipt.

1 I guess they got it on Tuesday, was actually able to be there
2 to talk to the entire list on Wednesday.

3 So, I think, as practical matter, from the time
4 I received the guide, it was a week, when I listed the issues
5 which we have discussed here today.

6 So, it's been a week since then that the staff
7 has been on notice of the content. In fact, a number of
8 them, as Ms. Bernstein has rightfully noted, were also included
9 in our earlier comment. Some of the issues are new. I
10 mentioned the ones that I thought were new.

11 MR. DURANT: Are there any -- other than what you've
12 given, are there any new issues relative --

13 MR. WALLACE: Mr. Chairman, is this really necessary?

14 MR. DURANT: This is the last question I want to
15 ask. Are there any other new issues?

16 MR. SIMPSON: I -- the answer to that is I have
17 none. There probably are, but I don't know what they are.

18 CHAIRMAN MENDEZ: Did I hear you make a motion
19 to adjourn?

20 MS. BERNSTEIN: I make a motion to adjourn.

21 CHAIRMAN MENDEZ: Do I hear a second?

22 MS. BENAVIDEZ: Yes.

23 CHAIRMAN MENDEZ: All in favor, stand up.

24 (Whereupon, at 4:00 p.m., the meeting was

25 adjourned.)

End T 3

REPORTER'S CERTIFICATE

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

DOCKET NUMBER:

CASE TITLE: Audit and Appropriations Committee Meeting

HEARING DATE: October 25, 1985

LOCATION: Washington, D.C.

I hereby certify that the proceedings and evidence herein are contained fully and accurately on the tapes and notes reported by me at the hearing in the above case before the LEGAL SERVICES CORPORATION and that this is a true and correct transcript of the case.

Date: October 25, 1985

James D. Jones

Official Reporter
ACME REPORTING COMPANY, INC.
1220 L Street, N.W.
Washington, D. C. 20005

