Office of Inspector General
Legal Services Corporation

3333 K Street, NW, 3rd Floor
Washington, DC 20007-3558
202.295.1660 (p) 202.337.6616 (f)
www.oig.lsc.gov

Jeffrey E. Schanz
Inspector General
Legal Services Corporation

Testimony Before the
Subcommittee on Commercial and Administrative Law
House Committee on the Judiciary

April 27, 2010

Introduction

Mr. Chairman, Congressman Franks, and other distinguished members, thank you for this opportunity to comment on H.R. 3764, the Civil Access to Justice Act of 2009. My name is Jeffrey Schanz. Since 2008, I have been Inspector General for the Legal Services Corporation. I was a founding member of the United States Department of Justice Office of Inspector General at its inception in 1989, and remained there until retiring as Director of the Office of Policy and Planning in 2008. All told, I have now spent more than 36 years performing audits and other types of IG work. Needless to say, I believe strongly in the values of accountability, effectiveness and efficiency that are mandated by the Inspector General Act of 1978, 5 U.S.C. app. 3.

Like all federal Inspectors General, it is my statutory duty to prevent and detect fraud, waste, and abuse and to make recommendations to the head of the agency to improve the efficiency and effectiveness of its programs and operations. The Inspector General also has a duty to keep the Congress fully and currently informed of his findings and activities, and to comment on existing and proposed legislation, regulations, and agency policies. Thus the Inspector General serves both Congress and the head of his or her agency with equal thoroughness and zeal.

The LSC OIG is charged with oversight not only of its parent agency but also of 136 separate legal aid grantees, which receive a substantial portion of their operating funds in the form of LSC grants. As Inspector general, I am obligated by statute to report serious problems to the LSC Board of Directors, and to notify appropriate law enforcement authorities when my office has found that there are reasonable grounds to believe that a crime has occurred. In addition, the LSC OIG provides periodic reports to the Board and management of LSC and to the Boards of Directors and management of LSC grantees. In order to carry out these responsibilities effectively, it is important that my office have unimpeded access to records and information, from both the Corporation and its grantees. See Section 6(a)(1) of the Inspector General Act of 1978, as amended, 5 U.S.C. app. 3, § 6(a)(1) (authorizing each Inspector General "to have access to all records, reports, audits, reviews, documents, papers, recommendations, or other material available to the applicable establishment which relate to programs and operations with respect to which that Inspector General has responsibilities under this Act").

Provided the "agency head is committed to running the agency effectively and to rooting out fraud, abuse and waste at all levels," the Inspector General "can be his strong right arm in doing so, while maintaining the independence needed to honor his reporting obligations to Congress." Inspector General Act of 1978, S. Rep. 95-1071, 95th Cong., 2nd Sess, p. 9. To ensure the objectivity of the IG, the IG Act grants the LSC IG the independence to determine what reviews are performed; gain access to all documents needed for OIG reviews; publish findings and recommendations based on OIG reviews; and report OIG findings and recommendations to the LSC Board of Directors and to Congress.

Although the OIG is not a part of LSC management, we serve as an objective and independent accountability expert for the LSC Board of Directors and LSC management. To

be effective, the OIG works cooperatively with the Board and management, seeks their input prior to choosing topics for OIG review, and keeps them informed of OIG activities. Within their different statutory roles, the OIG and management of LSC share a common commitment to improving the federal legal services program and increasing the availability of quality legal services to the poor.

Recent Activities

At this subcommittee's last hearing on the Legal Services Corporation, Chairman Cohen noted that LSC and some of its grantees had been criticized for inappropriate use of federal funds, noting that "there are special places held for people who steal from the poor." Chairman Cohen wanted to know what steps LSC had taken to "protect against misuse of federal funds and protect those funds entrusted to them for the benefit of people who need that help."

The LSC OIG has recently undertaken a number of steps to address such concerns. During the past 18 months, the LSC OIG has:

- Completed a series of audits following up on GAO review of LSC controls over grants management and oversight, and provided LSC management with "roll-up" memoranda summarizing audit findings and identifying matters requiring further management attention. Overall, we reported on issues affecting over $1.47 million in LSC or LSC-derivative funds, of which $435,000 was referred to management as questioned costs;

- Directed continuing audit efforts to review adequacy and effectiveness of internal controls at grantees; these audits have resulted in questioned costs of over $229,000.

- Investigated a former grantee employee who was subsequently indicted on 73 counts of mail fraud and thereafter pleaded guilty to defrauding the grantee and scores of its clients of thousands of dollars.

- Undertaken an investigation involving a grantee that was ordered to divest over $2 million in attorneys' fees and agreed not to seek LSC funding for five years.

- Conducted a joint investigation with the Department of Justice OIG of an acting executive director of a grantee for stealing tens of thousands of dollars in grant funds; the acting executive director was removed from his position and subsequently pleaded guilty to theft of federal grant monies under programs funded by LSC and the Department of Justice's Office of Violence Against Women.

- Launched a variety of initiatives to help prevent and deter fraud and abuse, including: fraud alerts issued to all executive directors to highlight issues and vulnerabilities identified in the course of OIG investigations or audits (e.g., control breakdowns that permitted a $200,000 embezzlement at one grantee); onsite fraud awareness briefings; onsite fraud vulnerability assessments; a guide on how to help prevent computer thefts; and significant improvements in Hotline awareness and operations.

In order to improve governance practices and improve accountability for federal funds, the LSC OIG has, during the same period:

• Conducted an audit of LSC controls and practices with respect to consultant contracting. The audit identified a number of issues requiring corrective action (e.g., potentially improper classification of consultants for tax purposes; inadequate adherence to internal controls; and multiple procedural weaknesses).

• Initiated an audit of LSC's Technology Initiative Grant Program.

• Conducted on-going oversight of the grantee audit process, including desk reviews of 100% of grantees' audit reports and more in-depth and onsite reviews of selected IPAs' audit work (Audit Service Reviews).

By continuing to press forward with these and similar activities, the LSC OIG is helping to root out fraud, waste, and abuse in LSC and its grantees, and to improve the efficiency and economy of the federal legal services program. Serving as an agent for positive change, the OIG continues to work with the LSC Board and LSC management to maximize the use of available funding by ensuring it is used to assist eligible indigent clients in resolving their legal problems.

H.R. 3764

Although H.R. 3764 contains positive measures to improve corporate governance and accountability, if enacted in its current form it could hamper my office's ability to carry out its statutory responsibilities to prevent and detect waste, fraud, and abuse in the Corporation and its grantees, to ensure compliance with applicable statutory and regulatory provisions, and to improve the effectiveness, efficiency and economy of the federal legal services program. I have outlined my concerns with the legislation below.

Audits

Certain provisions of H.R. 3764 could be read to undermine the LSC OIG's central oversight role in the grantee audit process, which is currently governed by Section 509 of the Omnibus Consolidated Rescissions and Appropriations Act of 1996, Pub. L. 104-134, 110 Stat. 1321 ("1996 Act"). To understand how the audit provisions of H.R. 3764 would affect the OIG requires some acquaintance with the historical background of LSC and the LSC OIG.

The LSC Act itself contains only a few provisions bearing directly on the audit function. Section 1009(c) of the LSC Act requires the Corporation to "conduct, or require each grantee, contractor, or person or entity receiving financial assistance under this subchapter to provide for, an annual financial audit." 42 U.S.C. § 2996h(c). In addition, Section 1009(c) sets forth certain administrative requirements; for example, the Corporation must retain audit reports for five years, and make copies of the reports available to GAO and members of the public. See id. at § 2996h(c)(1), (2). The audits

mandated by the LSC Act are required to be performed in accordance with Generally Accepted Auditing Standards ("GAAS").

LSC did not have an Inspector General at the time of the 1974 LSC Act or the 1977 LSC Reauthorization Act. Thus, the audit provisions in the LSC Act do not take into account the powers and responsibilities of the LSC Inspector General, which came into existence in 1989. In the Inspector General Act of 1978, Pub. L. 95-452, 92 Stat. 1101, Congress consolidated all non-programmatic audit operations under the Inspectors General. *See* 5 U.S.C. app. 3, § 8E(b) (requiring head of DFE to transfer "offices, units, or other components" with OIG-related functions to OIG); S. Rep. No. 150, 100th Cong., 1st Sess., at 3 (1987) ("defining "IG 'concept'" as involving "the consolidation of an agency's audit and investigative functions and resources under a single high-level official reporting directly to the agency head").

Moreover, Section 1005(e)(1) of the LSC Act specifies that the Corporation "shall not be considered a department, agency, or instrumentality, of the Federal Government." 42 U.S.C. § 2996d(e)(1). As a result, laws that apply generally to federal departments, agencies and instrumentalities do not apply to LSC absent a specific provision to the contrary. As a result, neither the myriad of federal financial management and governance laws that have been enacted over the past 33 years (such as the Single Audit Act of 1984 and the Single Audit Act Amendments of 1996) nor OMB Circulars such as A-133 (audits of state and local governments and nonprofits receiving federal grants) are applicable to LSC and its grantees.

Recognizing the statutorily-mandated role and duties of the LSC OIG and hoping to improve accountability for LSC funds, in 1996 Congress made a number of significant changes to the grantee audit process by enacting Section 509 of the 1996 Act. Section 509: (1) mandated routine on-site monitoring of grantee compliance by means of annual audits conducted by independent public accountants ("IPAs"); (2) provided that such audits be conducted in accordance with Generally Accepted Government Auditing Standards ("GAGAS") pursuant to guidance established by the LSC OIG; (3) established special requirements for interim reporting by recipients concerning noncompliance with laws and regulations identified by their IPAs during the course of audits; (4) gave the Corporation, upon the recommendation of the OIG, authority to impose sanctions on recipients failing to conduct audits in accordance with OIG guidance; and (5) provided for OIG removal, suspension, or debarment of IPAs upon a showing of good cause after notice and opportunity for a hearing. See 110 Stat. 1321, Sec. 509(a)-(d).

The legislative history underlying Section 509 makes clear that Congress intended to ensure the LSC OIG a central role in the conduct of grantee audits. In particular, the conference report notes that Section 509 includes:

> modifications to language proposed by the Senate to clarify that *only the Office of the Inspector General shall have oversight responsibility to ensure the quality and integrity of the financial and compliance audit process*. Language is also included, as proposed by the Senate, to

> clarify the Corporation management's duties and responsibilities to resolve deficiencies and non-compliance reported by the Office of the Inspector General. Further, language is included, as proposed by the Senate, authorizing the Office of the Inspector General to conduct additional on-site monitoring, audits, and inspections necessary for programmatic, financial and compliance oversight.

HOUSE RPT. 104—537 (emphasis supplied).

Moreover, the 1996 Act made clear that this new audit regime was to be "in lieu of the financial audits otherwise required by section 1009(c)" of the LSC Act. 1996 Act, § 509(h). Thus, Section 509 aligned, for the first time, LSC grantee audit requirements with the pre-existing statutory responsibility of Inspectors General to "take appropriate steps to ensure that any work performed by non-Federal auditors complies with the standards established by the Comptroller General [for audits of federal establishments]". 5 U.S.C. app. 3, § 4(b)(1)(C). See generally S. Rep. 95-1071, "Inspector General Act of 1978," Sept. 22, 1978, p. 2687 (noting that standards established by the Comptroller General of the United States – i.e., GAGAS – are preferable to GAAS for audits involving federal funds).

The 1996 Act established a new grantee audit regime at LSC, both expanding the scope of recipient audits and clarifying the role of the LSC OIG in overseeing them. Moreover, by enacting Section 509, Congress attempted to bring oversight of LSC grantee audits more in line with the standards that had already been made applicable to audits of states, local governments, and nonprofit organizations receiving federal grants by the Single Audit Act of 1984, P.L. 98-502, the Single Audit Act Amendments of 1996, P.L. 104-156, and OMB Circular A-133.

H.R. 3764, however, would eliminate the audit-related requirements of Section 509. By doing so H.R. 3764 would take LSC backwards to a time when the respective roles of LSC management, the LSC OIG, and the IPAs were unclear, leading to unnecessary confusion and overlap in functions and activities between various LSC offices. In an August 2007 report, the GAO specifically identified such confusion and overlap as a contributing factor in LSC's weak governance and accountability practices. See Legal Services Corporation: Governance and Accountability Practices Need to Be Modernized and Strengthened, GAO-08-37.

Inexplicably, Section 15 of H.R. 3764 ignores the IG Act's explicit grant of authority to OIGs to oversee work performed by non-federal auditors. Nor does the bill mention the OIG's important role in promulgating standards and in providing oversight to "ensure the quality and integrity of the financial and compliance audit process." Instead, it merely provides that the "Corporation shall require an audit" of each recipient. Nor does the bill acknowledge the IG Act's requirement that work performed by non-federal auditors conform to Government Auditing Standards.

H.R. 3764 would relax IPA audit requirements in other ways as well. Under current law, IPAs are required to "report whether –

> (1) the financial statements of the recipient present fairly its financial position and the results of its financial operations in accordance with generally accepted accounting principles;
>
> (2) the recipient has internal control systems to provide reasonable assurance that it is managing funds, regardless of source, in compliance with Federal laws and regulations; and
>
> (3) the recipient has complied with Federal laws and regulations applicable to funds received, regardless of source.

Pub. L. 104-134, § 509(a)(1)-(3).

H.R. 3764 would weaken these standards in several subtle ways. First, unlike Section 509, it would not require IPAs to report whether the recipient's financial statements fairly present its financial position; whether the recipient has internal control systems meeting certain standards; and whether the recipient has complied with the applicable laws and regulations. Instead, H.R. 3764 would merely require each recipient to "prepare a report that includes . . . the financial statements of the recipient, including an unbiased presentation of the recipient's financial position and the results of the recipient's financial operations [and] . . . a description of internal control systems of the recipient that provide reasonable assurance that the recipient is managing funds, from all sources, in compliance with Federal law."

Additionally, H.R. 3764 incorporates none of the provisions of the 1996 Act setting forth special requirements for interim reporting by recipients concerning noncompliance with laws and regulations identified by their IPAs during the course of an audit, and allowing the Corporation to impose sanctions on IPAs who fail to conduct audits in accordance with OIG guidance.

By eliminating specific reference to the OIG's central oversight role in the grantee audit process, the audit provisions of H.R. 3764 appear to run counter to the intent of the Inspector General Act of 1978 to consolidate all non-programmatic audit operations under the Inspectors General, see 5 U.S.C. app. 3, § 8E(b), and vest the OIGs with the responsibility to "provide policy direction for and to conduct, supervise, and coordinate audits and investigations relating to the programs and operations of such establishment." 5 U.S.C. app. 3, § 4(a)(1).

The changes H.R. 3764 would work in LSC's auditing regime are not just cosmetic. GAGAS audits are mandated for entities with statutory Inspectors General because they carry greater assurance of accuracy and accountability than do those conducted pursuant to GAAS. In comparison with GAAS, GAGAS requires the maintenance of higher standards with respect to auditor qualifications, the quality of the audit effort, and the

required contents of audit reports. By repealing the requirement that audits of LSC grantees be conducted in accordance with GAGAS, H.R. 3764 would return the Corporation to the confusing state of affairs that existed in 1992, when 38% of the grantee audits submitted to LSC were conducted in accordance with GAGAS and the remainder were conducted in accordance with GAAS. Like virtually every other non-profit entity that receives substantial federal grant funding, LSC recipients should be required to account for their use of federal dollars in accordance with rigorous government auditing standards.

In this regard, moreover, H.R. 3764 runs counter to the clear intent of the Inspector General Act of 1978, *i.e.,* to bolster the ability of Federal OIGs to "provide policy direction for and to conduct, supervise, and coordinate audits and investigations relating to the programs and operations of such establishment." 5 U.S.C. app. 3, § 4(a)(1) (IG Act).

Unlike other nonprofits receiving federal grants, which are required by OMB Circular A-133 to be audited pursuant to Government Auditing Standards, under H.R. 3764 LSC grantees would no longer be required to be audited pursuant to these well-established standards.

Replacing Section 509 of the 1996 Act with reporting requirements that are less rigorous than those imposed on federal grantees by OMB Circular A-133 would substantially increase the risk that more funds will be lost as a result of unreasonable or unsupportable expenditures, as well as fraud, embezzlement, or simply poor bookkeeping.

In this respect, H.R. 3764 appears to conflict with the statutory mandates of the IG Act, which requires Inspectors General to ensure that non-federal auditors examining federal programs adhere to Government Auditing Standards. See 5 U.S.C. app. 3, § 4(b)(1)(C) ("[I]n carrying out the responsibilities specified in subsection (a)(1), each Inspector General shall . . . take appropriate steps to ensure that any work performed by non-Federal auditors complies with the standards established by the Comptroller General [for audits of Federal establishments]").

To address these problems, I recommend that H.R. 3764's current provision relating to audits and audit requirements be deleted and replaced with a provision specifying that such audits should be conducted in accordance with the reporting requirements set forth in OMB Circular A-133, which sets forth the requirements applicable to audits of states, local governments, and nonprofits expending federal funds.

In addition, I recommend that Section 1009 of the LSC Act be amended to specify that the Inspector General shall oversee all grantee audits, and that such audits must be conducted in accordance with GAGAS. In addition, as the LSC Act has not been amended since LSC became subject to the IG Act in 1988, H.R. 3764 should be amended to include a general statement to the effect that nothing in the amended LSC Act should be construed to diminish or otherwise affect the authorities or responsibilities of the Inspector General pursuant to the Inspector General Act of 1978, as amended.

Access to Records

By restricting the OIG's access to information protected from disclosure to third parties by state and local bar rules, H.R. 3764 would substantially restrict the OIG's access to grantee information and seriously hamper its ability to carry out meaningful audits and investigations.

It is a long-established principle that the federal law of privilege generally applies in subpoena enforcement proceedings brought by federal entities. See Linde Thomson Langworthy Kohn & Van Dyke, P.C. v. Resolution Trust Corp., 5 F.3d 1508, 1513 (D.C. Cir. 1993). The LSC Act, however, adds a slight complication to this principle in its application to the LSC OIG (which was not in existence at the time the LSC Act was last amended). Specifically, Section 1006(b)(3) of the Act, 42 U.S.C. § 2996e(b)(3), provides that LSC may not

> interfere with any attorney in carrying out his professional responsibilities to his client as established in the Canons of Ethics and the Code of Professional Responsibility of the American Bar Association . . . or abrogate as to attorneys in programs assisted under this subchapter the authority of a State or other jurisdiction to enforce the standards of professional responsibility generally applicable to attorneys in such jurisdiction.

Because an Inspector General's access to records is limited to those "available to the applicable establishment which relate to programs and operations with respect to which that Inspector General has responsibilities", 5. U.S.C. app. 3, § 6(a)(1), the LSC OIG initially had considerable difficulty obtaining client names and other case-related information (which is not, as a rule, protected by the attorney-client privilege) based in part on interpretations of state bar rules, which generally require lawyers to protect the confidentiality of virtually all information relating to clients. On a number of occasions recipients' denial of such information made it extremely difficult for the LSC OIG to carry out routine work, including case reporting audits; audits of client trust fund accounts; and client satisfaction surveys.

Congress attempted to address these access problems by crafting Section 509(h) of the 1996 Act, which expressly supersedes the restrictions of §1006(b)(3). Section 509(h) provides:

> Notwithstanding section 1006(b)(3) of the Legal Services Corporation Act (42 U.S.C. 2996e(b)(3)), financial records, time records, retainer agreements, client trust fund and eligibility records, and client names, for each recipient shall be made available to any auditor or monitor of the recipient, including any Federal department or agency that is auditing or monitoring the activities of the recipient, and any independent auditor or monitor receiving Federal funds to conduct such auditing or monitoring, including any auditor or monitor of the

Corporation, except for reports or records subject to the attorney-client privilege.[1]

Despite the clear language of Section 509(h), LSC grant recipients have continued to invoke state rules of professional responsibility to resist the enforcement of OIG subpoenas. So far, these attempts have been unsuccessful. See U.S. v. Legal Services for New York City, 249 F.3d 1077, 1083 (D.C. Cir. 2001) ("LSNYC") (noting that "§ 509(h) is an explicit exception to § 2996e(b)(3)"); Bronx Legal Services v. Legal Services Corp., 2002 WL 1835597, at * 4 (S.D.N.Y. Aug. 8, 2002) ("[E]ven if the requested information does constitute a client secret, plaintiffs are relieved of any perceived ethical obligations to withhold client names and the nature of the representation because they are required by [§ 509(h)] to disclose the requested information").

Notwithstanding the foregoing precedents, one grantee which is currently engaged in resisting disclosure of records to the LSC OIG in a subpoena enforcement action has recently invoked Section 1006(b)(3) in support of its contention that state law ethical obligations prohibit it from disclosing client-related information to the OIG. See 9/14/07 Opposition to Petition for Subpoena Enforcement, at 37-40, United States of America v. California Rural Legal Assistance, Inc, 07-mc-123 (D.D.C.). (Making matters even more confusing, the grantee has contended that the state law of attorney-client privilege, in addition to the federal attorney-client privilege, may be applicable to the withheld records. See id. at 37-40.)

H.R. 3764 would worsen this situation considerably. First, Section 7 of the bill would delete LSC Act Section 1006(b)(3)'s reference to the "Canons of Ethics and the Code of Profession Responsibility of the American Bar Association," and replace it with a reference to the "applicable rules of professional responsibility or other laws of the State or other jurisdiction where the attorney practices law". Second, Section 11 of the bill would add a new provision to the LSC Act requiring that the Corporation's "monitoring and evaluation activities" be "carried out in a manner that is consistent with the applicable rules for the jurisdiction in which the recipient is being monitored, and . . . take reasonable steps to avoid imposing undue burden or expense on the recipient." Third, Section 13 of the bill would require that the OIG would not "have access to any information . . . that is confidential under the applicable rules of professional responsibility or that is subject to the attorney-client privilege." And fourth, the bill contains no provision comparable to Section 509(h) of the 1996 Appropriations Act, which provides the OIG access to "financial records, time records, retainer agreements, client trust fund and eligibility records, and client names", notwithstanding the provisions of § 1006(b)(3). In combination, these changes in the current statutory regime could erode the LSC OIG's ability to obtain records necessary to carrying out audits and investigations.

Thus, in its current form, H.R. 3764 would place the LSC OIG in a highly disadvantageous position by forcing it to reckon with not only the varying laws of

[1] The terms and conditions to which the 1996 Act subjected LSC funding, including those bearing on the authorities of the OIG, have been incorporated by reference into all subsequent appropriations acts.

privilege in each distinct state or territory, but also with the professional responsibility rules of each jurisdiction, each time it sought information from LSC grantees. Moreover, the bill's requirement that LSC take "reasonable steps to avoid imposing undue burden and expense" on a grantee when carrying out the "monitoring and evaluation activities" set forth in Section 1007 would undoubtedly spark unnecessary disputes over the questions of undue burden and expense, which the OIG is already required to consider in the context of subpoena enforcement actions. See Linder v. National Sec. Agency, 94 F.3d 693, 695 (D.C. Cir. 1996) (district court is authorized to quash or modify unduly burdensome subpoena).

In sum, by depriving the LSC OIG of the ability to obtain records from the grantees it is charged with overseeing, the statutory alterations proposed in H.R. 3764 would leave several hundred million dollars in federal funds to be spent with considerably less oversight and accountability than at present. In this respect H.R. 3764 runs directly counter to the intent of Congress, as expressed in the recently-enacted Inspector General Reform Act of 2008, to enhance the authority of federal Inspectors General to root out waste, fraud, and abuse in federally-funded programs. By complicating access by the OIG and other monitors to recipient files, subjecting auditors and investigators to the various provisions of state and territorial rules of professional responsibility, H.R. 3764 would guarantee endless litigation over the terms of access to recipient files, and thereby allow LSC grantees to evade all but the most superficial oversight over their expenditures of federal funds.

To address this problem in the current version of H.R. 3764, the LSC OIG proposes engrafting the access provision of Section 509(h) into the bill, with the additional clarification that only information subject to the federal attorney-client privilege may be withheld from auditors or monitors of the grant recipient. In addition, all references to the "applicable rules of professional responsibility" of the several states and territories should be deleted from the statutory text wherever they appear.

Federal Funds

Unlike current law, H.R. 3764 contains no provision stipulating that LSC grants are to be considered federal funds for purposes of certain statutes. Accordingly, the bill would deprive the LSC OIG of a useful tool for safeguarding taxpayer funds (a risky proposition, as recent OIG audits and investigations have highlighted).

Among the provision of the 1996 Act that govern the use of LSC funds is Section 504(a)(19), which provides:

> None of the funds appropriated in this Act to the Legal Services Corporation may be used to provide financial assistance to any person or entity . . . unless such person or entity enters into a contractual agreement to be subject to all provisions of Federal law relating to the proper use of Federal funds, the violation of which shall render any grant or contractual agreement to provide funding null and void, and,

> for such purposes, the Corporation shall be considered to be a Federal agency and all funds provided by the Corporation shall be considered to be Federal funds provided by grant or contract.

To implement Section 504(a)(19), LSC has promulgated regulations identifying the following statutes as applicable to money dispensed by the Corporation:

- 18 U.S.C. § 201 (Bribery of Public Officials and Witnesses)
- 18 U.S.C. § 286 (Conspiracy to Defraud the Government With Respect to Claims)
- 18 U.S.C. § 287 (False, Fictitious, or Fraudulent Claims)
- 18 U.S.C. § 371 (Conspiracy to Commit Offense or Defraud the United States)
- 18 U.S.C. § 641 (Public Money, Property, or Records)
- 18 U.S.C. § 1001 (False Statements or Entries)
- 18 U.S.C. § 1002 (Possession of False Papers to Defraud the United States)
- 18 U.S.C. § 1516 (Obstruction of Federal Audit)
- 31 U.S.C. § 3729-33 (Civil False Claims) (except that *qui tam* actions authorized by § 3730(b) may not be brought against the Corporation or its grantees)

45 C.F.R. § 1640.2(a)(1).

As with the previously-discussed provision conditioning the LSC OIG's access to grantee records on state professional responsibility rules, H.R. 3764's omission of a provision applying laws concerning the proper expenditure of federal funds would leave several hundred million dollars in federal funds to be spent with considerably less accountability than at present.

Section 504(a)(19) is the product of a longstanding bipartisan consensus that LSC funds should be considered federal funds for purposes of statutes bearing upon the proper use of federal funds; a substantially similar provision was included in H.R. 2039, the Legal Services Reauthorization Act of 1991, which was the last LSC reauthorization bill to pass either House of Congress. (H.R. 2039, introduced by Rep. Barney Frank (D-Mass.), passed the House of Representatives by the bipartisan margin of 253-154 on May 12, 1992.)

Although H.R. 2039 stalled in the Senate, in 1993 Representative John Bryant (D-TX) used the unaltered text of H.R. 2039 as the starting-point for H.R. 2644, the LSC reauthorization bill he introduced in the following (103rd) Congress. (H.R. 2644 never made it out of the House Subcommittee on Administrative Law and Governmental Relations.)

Both H.R. 2039 and H.R. 2644 provided that the Corporation was to be considered a "department or agency of the United States Government" for purposes of 18 U.S.C. §§ 286, 287, 641, 1001 and 1002; "the term 'United States Government' [was to] include the Corporation" for purposes of 31 U.S.C. §§ 3729-33; LSC auditors were to be considered "Federal auditors" for purposes of 18 U.S.C. § 1516; funds provided by the Corporation

were to be "deemed Federal appropriations when used by a contractor, grantee, subcontractor, or subgrantee of the Corporation"; and LSC funds were to be deemed "benefits under a Federal program involving a grant or contract" for purposes of 18 U.S.C. § 666, which concerns theft or bribery involving federally-funded programs. See H.R. 2039, 102nd Cong., 2nd Sess., at § 4 (reported with an amendment, Mar. 31, 1992); H.R. 2644, 103rd Cong., 1st Sess., § 4 (introduced July 15, 1993).

In addition to receiving bipartisan support in the Congress, the "federal funds" provision in H.R. 2644 received the approval of the Clinton Administration. See Hearing Before the Subcommittee on Administrative Law and Governmental Relations of the Committee on the Judiciary, 103rd Cong., 1st Sess., on H.R. 2644 (Sept. 22, 1993) (Prepared Statement of Webster L. Hubbell, Associate Attorney General), at 89:

> The flip side of local control is the need for effective, yet nondisruptive monitoring by the Corporation to make sure the services being provided with federal funds are efficient and effective. H.R. 2644 adeptly balances these competing goals. The bill provides a variety of new protections to guard against the misuse or misappropriation of Corporation funds. For example, the theft or embezzlement of funds provided by the Corporation will be treated like theft or embezzlement of any other federal appropriation under our criminal statutes.

The LSC reauthorization bills introduced in the Republican-led 104th Congress were, in many ways, quite different from those introduced in the 102nd and 103rd Congresses. In at least one respect, however, they were identical to their predecessor bills: both the House and Senate bills contained language identical to that in the Frank and Bryant bills requiring LSC funds to be deemed federal funds for certain purposes. See H.R. 1806, 104th Cong., 1st Sess., § 5 (introduced June 8, 1995 by Rep. McCollum); S. 1221, 104th Cong., 1st Sess., § 5 (introduced Sept. 7, 1995 by Senator Kassebaum).

It should be noted that theft or embezzlement of LSC funds is not an unheard-of phenomenon among LSC recipients. In a recent Semiannual Report to Congress, for example, the LSC OIG reported that a grantee employee with the responsibility for preparing checks and reconciling bank statements had been making checks out to herself and depositing them into her personal account. See LSC OIG Semiannual Report, April 2009, at 12. The investigation revealed that the employee had embezzled roughly $200,000 of program funds to pay for personal expenses by writing checks from the program payable to herself; using the program's debit and credit cards for cash withdrawals and personal purchases; and using the program's general bank account to pay for her personal credit cards via electronic payment. See id. The LSC OIG recently referred this matter to the United States Department of Justice for prosecution under federal laws.

There is no reason why congressionally-appropriated LSC funds should lose their federal character for purposes of allowing federal prosecutions in cases of bribery, theft, fraud, or embezzlement. Moreover, in this respect H.R. 3764 runs directly counter to the intent of

Congress, as expressed in the recently-enacted Inspector General Reform Act of 2008, to enhance the authority of federal Inspectors General to root out waste, fraud, and abuse in federally-funded programs.

To rectify this deficiency in H.R. 3764, I recommend that the Committee adopt a provision similar to Section 504(a)(19) of the 1996 Act, but modified to correct certain deficiencies of Section 504(a)(19).

Although there is no indication in the legislative history of the 1996 Act why the specific statutory references were omitted from the appropriations rider that ultimately became Section 504(a)(19) (following the veto of two previous appropriations bills), it is clear that LSC took its cue from the cognate provisions in the pre-1996 reauthorization bills when it published its regulations implementing Section 504(a)(19). See 62 Fed. Reg. 19424, 19425 (noting that H.R. 1806 "expressly cites most of the laws included in this part").

Nevertheless, while Section 504(a)(19) requires that grantees agree to be bound by *all* federal statutes relating to the proper use of federal funds, LSC's implementing regulations, at 45 C.F.R. § 1640, do not identify all federal statutes relating to the proper use of federal funds.

In particular, the regulations contain no mention of 18 U.S.C. § 666, which is the primary federal statute to prosecute cases involving theft or bribery involving non-federal officials who have been entrusted to administer federal funds. It was enacted to "fill a gap caused by the difficulty of tracing federal monies" in prosecutions undertaken pursuant to 18 U.S.C. § 641, which covers theft or embezzlement of federal property. United States v. Westmoreland, 841 F.2d 572, 576 (5th Cir. 1988). As the Senate Report on Section 666 explained:

> [T]here is no statute of general applicability in this area, and thefts from other organizations or governments receiving Federal financial assistance can be prosecuted under the general theft of Federal property statute, 18 U.S.C. § 641, only if it can be shown that the property stolen is property of the United States. In many cases, such prosecution is impossible because title has passed to the recipient before the property is stolen, or the funds are so commingled that the Federal character of the funds cannot be shown. This situation gives rise to a serious gap in the law, since even though title to the monies may have passed, the Federal Government clearly retains a strong interest in assuring the integrity of such program funds. Indeed, a recurring problem in this area (as well as in the related area of bribery of the administrators of such funds) has been that State and local prosecutors are often unwilling to commit their limited resources to pursue such thefts, deeming the United States the principal party aggrieved.

S.Rep. No. 225, 98th Cong., 2d Sess. 369, *reprinted in* 1984 U.S. Code Cong. & Admin. News 3182, 3510, as quoted in Westmoreland, 841 F.2d at 576-77.

Given the widely-recognized inadequacy of Section 641 for the prosecution of thefts of federal grant funds by non-federal officials, and the evident Congressional intent to include Section 666 among those federal laws which were to be made applicable to LSC funds by Section 504(a)(19) of the 1996 Act, see H.R. 2039, 102nd Cong., 2nd Sess., at § 4; H.R. 2644, 103rd Cong., 1st Sess., § 4; H.R. 1806, 104th Cong., 1st Sess., § 5; S. 1221, 104th Cong., 1st Sess., § 5 (making Section 666 applicable to LSC funds), I recommend that H.R. 3764 correct this oversight by making Section 666 applicable to LSC funds.

Timekeeping

Other provisions of H.R. 3764 are troubling as well. For example, the bill would make it more difficult for the LSC OIG and other monitors to ascertain the source of funding behind grantee activities by repealing current statutory provisions that require recipients to account separately for receipts and disbursements of LSC and non-LSC funds. In addition, the bill would repeal the current statutory requirement that grantees make their timekeeping records available to monitors. Pub. L. 104-134, § 504(a)(10)(A)-(C).

Prior to the 1996 Act, LSC grantees were required to account for and report receipts and disbursements of non-LSC funds as "separate and distinct" from LSC funds. In the absence of any timekeeping requirement for recipient staff, however, it was difficult for an outside monitor to assess whether LSC funds had been used for prohibited purposes.

Section 504(a)(10) of the 1996 Act went some way toward remedying this situation by requiring recipients to "maintain records of time spent on each case or matter"; account for funds received from sources other than LSC "as receipts and disbursements . . . separate and distinct from Corporation funds"; and make their timekeeping records available to auditors and other monitors (including the LSC OIG). See Pub. L. 104-134, Section 504(a)(10)(A)-(C).

H.R. 3764, however, would make it even more difficult than at present for monitors to ascertain the source of funding behind grantee activities. In place of Section 504(a)(10)'s somewhat detailed recordkeeping requirements, Section 11 of H.R. 3764 would merely require LSC to ensure that "all attorneys and paralegals employed by a recipient . . . maintain records of time spent on each case or matter supported in whole or in part with funds provided under this title."

Not only would H.R. 3764 fail to improve grantees' accountability for LSC funds; it would actually repeal the current statutory requirement that grantees make their timekeeping records available to monitors. Pub. L. 104-134, § 504(a)(10)(A)-(C).

What is more, H.R. 3764 would loosen these accountability requirements at the same time as it would repeal the 1996 Act's restrictions on grantees' use of non-LSC funds for restricted activities. In combination, these two innovations would make it nearly

impossible for the OIG or any other monitor to ensure that LSC funds are not being spent in furtherance of prohibited activities. The LSC OIG has surfaced a number of problems in recent years indicating more oversight is required, not less.

By seriously weakening the OIG's ability to monitor grantees' use of federal dollars, this provision of H.R. 3764 runs directly counter to the intent of Congress, as expressed in the Inspector General Reform Act of 2008, to enhance the authority of federal Inspectors General to root out waste, fraud, and abuse in federally-funded programs.

To remedy this deficiency in H.R. 3764, I recommend that, at the very least, the bill be amended to include the timekeeping requirements set forth in Section 504(a)(10) of the 1996 Act. In addition, given LSC's past disinclination to amend its Part 1635 regulations to require grantees to implement a timekeeping system that links employee time records to the relevant funding source, the OIG recommends that the bill be amended to include such a requirement in the LSC Act itself, a requirement that would greatly increase accountability for the use of funds throughout the LSC-funded legal services delivery system.

Competition

H.R. 3764 would eliminate a number of statutory provisions that Congress has put in place in an attempt to bring about competition in the LSC grant award process. These provisions, which Congress inserted in the 1996 and 1998 LSC Appropriations Acts, require that LSC mandate publicly announced grant competitions; consider a grantee's history of compliance (or noncompliance) with applicable statutes and regulations when making grant award decisions; avoid giving preferential treatment to previous grantees; and institute a new selection process upon a finding of noncompliance. They also allow LSC to debar a recipient for good cause.

In place of these pro-competition provisions, H.R. 3764 would require only that LSC ensure basic field grants are distributed "on the basis of a system of competitive bidding, in accordance with Legal Services Corporation regulations . . . ."

Prior to enactment of the Omnibus Consolidated Rescissions and Appropriations Act of 1996, Pub.L. No. 104-134 (1996) ("1996 Act"), incumbent LSC grantees enjoyed presumptive refunding by virtue of two provisions of the LSC Act. First, Section 1007(a)(9) of the LSC Act requires the Corporation to ensure that each recipient applying for refunding "is provided interim funding necessary to maintain its current level of activities" until the refunding has been approved and the funds have been received by the grantee, or the application has been finally denied. See 42 U.S.C. § 2996f(a)(9). Second, Section 1011 of the Act prohibits LSC from terminating a grant or denying a refunding application unless the recipient "has been afforded reasonable notice and opportunity for a timely, full and fair hearing...." 42 U.S.C. § 2996j(2).

Section 503(b) of the 1996 Act abolished the presumptive refunding regime and required LSC to implement a competitive selection process in the awarding of grants.

Section 503(c) of the 1996 Act, in turn, required LSC to issue implementing regulations specifying certain selection criteria for grantees competing for LSC grants, including:

> (1) a demonstration of a full understanding of the basic legal needs of the eligible clients to be served and a demonstration of the capability of serving the needs; the quality, feasibility, and cost effectiveness of a plan submitted by an applicant for the delivery of legal assistance to the eligible clients to be served; and (2) the experience of the Legal Services Corporation with the applicant, if the applicant has previously received financial assistance from the Corporation, including the record of the applicant of past compliance with Corporation policies, practices, and restrictions.

Pursuant to Section 503(d), such regulations must

> ensure that timely notice regarding an opportunity to submit an application for such an award is published in periodicals of local and State bar associations and in at least 1 daily newspaper of general circulation in the area to be served by the person or entity receiving the award.

In addition, Section 503(e) provides: "No person or entity that was previously awarded a grant or contract by the Legal Services Corporation for the provision of legal assistance may be given any preference in the competitive selection process."

LSC issued the required regulations, establishing a competitive grant application process that implements the requirements of Section 503. See 45 C.F.R. § 1634 (requiring LSC to consider compliance history in grant award process; mandating public notice of grant availability; and forbidding preferences to incumbent grantees).

In LSC's 1998 appropriation Congress added additional requirements to the competitive selection process. Section 501(b) of the 1998 Commerce, State, and Justice Appropriations Act, Pub. L. 105-116 ("1998 Act"), bolstered LSC's ability to implement a competitive grant application process by rendering Sections 1007(a)(9) and 1011 of the LSC Act inapplicable to the competitive selection process.

In addition, Section 501(c) of the 1998 Act provides that the Corporation may institute a new competitive selection process for a recipient's service area during the grant term if it finds, after notice and an opportunity for the recipient to be heard, that the recipient has failed to comply with the LSC Act or any other applicable statute.

Finally, Section 504 of the 1998 Act gives the Corporation authority to debar recipients ("on a showing of good cause") from receiving additional LSC grants, provided the recipient has received notice and an opportunity to be heard.

H.R. 3764 would delete Section 1007(a)(9) and render inapplicable all provisions contained in the 1996 and 1998 Acts, while re-activating Section 1011 of the LSC Act, which requires that grantees be afforded notice and a hearing before funding is suspended or terminated, or an application for refunding denied. See 42 U.S.C. § 2996j.

Thus, although Section 11 of H.R. 3764 would require that LSC ensure basic field grants are distributed "on the basis of a system of competitive bidding, in accordance with Legal Services Corporation regulations," H.R. 3764 in fact *removes* all the statutory provisions that have been put in place to encourage and implement actual competition.

Moreover, under H.R. 3764, LSC would once again be required to comply with the time-consuming procedures of Section 1011 of the LSC Act before it could deny an application for refunding, or terminate or suspend a grantee's funding. This provision runs directly counter to the effort to promote competition for LSC grants, and would severely limit the Corporation's ability to deal with grantees engaging in fraudulent practices; non-performing grantees; and grantees failing to comply with the requirements of federal law. (Although these provisions do not directly affect matters within the OIG's jurisdiction, we have a duty to comment on them because of their tendency to increase the number of opportunities for fraud, waste and abuse within LSC programs and their effect on the efficiency and effectiveness of LSC programs and operations.)

In addition, while LSC regulations currently embody the requirements of Section 503 of the 1996 Act, there is nothing in H.R. 3764 requiring that *future* LSC regulations mandate publicly announced grant competitions; require consideration of a grantee's history of compliance (or noncompliance) with applicable statutes and regulations when making grant award decisions; avoid giving preferential treatment to previous grantees; or allow the Corporation to institute a new selection process upon a finding of noncompliance, or debar a recipient for good cause.

Although there is currently little competition for LSC grants despite Section 503's mandate, H.R. 3764 would unnecessarily diminish the likelihood of any future competition by removing entirely the competition standards put in place by the 1996 and 1998 Acts, and reinstating the cumbersome procedures mandated by Section 1011 of the LSC Act.

To remedy the foregoing deficiencies in H.R. 3764, the LSC OIG recommends that H.R. 3764 be amended to include a competition requirement that, at the very least, forbids preferential treatment for incumbent grantees; mandates public notice of grant availability; and requires the Corporation to consider a grantee's compliance history when making grant award decisions.

In addition, the LSC OIG recommends that the competition provisions of the 1996 and 1998 Acts be included so as to facilitate the competitive process and remove unnecessary barriers to recompetition in the event an incumbent grantee is failing to comply with the LSC Act or other applicable statutes.

Finally, the LSC OIG recommends that, in the interests of promoting competition for LSC grants, Section 1011 of the LSC Act be deleted.

Conclusion

By weakening the LSC OIG's oversight role in grantee audits, depriving LSC funds of their federal character, and limiting the LSC OIG's access to grantee records, many of the provisions of H.R. 3764 run directly counter to Congress' intent, as expressed in the recently-enacted Inspector General Reform Act of 2008, to enhance the authority of federal Inspectors General to root out waste, fraud, and abuse in federally-funded programs.

This is worrisome given that the appropriations authorized for LSC under H.R. 3764 would be roughly double the Corporation's current appropriation. It is also troubling in light of recent reports issued by the Government Accountability Office strongly indicating that LSC needs to implement improved governance and accountability practices, and to improve its grantee oversight practices. See August 2007 GAO Report, Legal Services Corporation: Governance and Accountability Practices Need to Be Modernized and Strengthened, GAO-07-993; December 2007 GAO Report, Legal Services Corporation: Improved Internal Controls Needed in Grants Management and Oversight, GAO-08-37. See also 7/7/09 Audit of Legal Services Corporation's Consultant Contracts (finding that LSC did not regularly follow its own written policies and procedures on consultant contracting process, and may have entered into independent contractor agreements with individuals who should have been classified as employees under IRS rules); 8/10/09 Report on Selected Internal Controls, Legal Aid of Northwest Texas (finding unsupported expenditure of $188,522 by Legal Aid of North West Texas for multi-story stone wall composed of imported Italian stone).

I appreciate the opportunity to offer my views on this proposed legislation, and I am hopeful that some consensus can be achieved on the issues I outlined above. Accountability, responsibility and transparency in the expenditure of taxpayer dollars should not be a controversial issue. I stand ready to assist the committee in incorporating the changes I have outlined above to ensure the LSC Office of Inspector General can truly function as the "strong right arm" of the Legal Services Corporation, helping to ensure the most efficient and effective use of limited federal funds for the Corporation's critical mission: "Equal Justice for All."