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Description of document: **US Legal Services Corporation (LSC) Office of Inspector General Memorandum giving background information about the Corporation's procedure for selection of an independent public accountant ("IPA" or "auditor") to perform the annual audit of LSC's financial statements, January 2008**

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FOIA Officer, Office of Legal Affairs
3333 K Street, NW, 3rd Floor
Washington, DC 20007-3522

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Inspector General
Jeffrey E. Schanz

December 23, 2008

This is in response to your Freedom of Information Act (FOIA) request, received in this office on December 2, 2008, for a document containing a "historical and legal analysis of LSC's process for selecting an auditor to perform the annual corporate audit."

The document responsive to your request (which is enclosed) consists of six pages, which are being released in full.

If you are dissatisfied with this response you may appeal, within 90 days of your receipt of this letter, to:

Jeffrey E. Schanz, Inspector General
Legal Services Corporation
3333 K St., N.W., 3rd Floor
Washington, DC 20007

Both the envelope and the letter must be clearly marked "Freedom of Information Act Appeal."

Respectfully,

A handwritten signature in blue ink, appearing to read "Tom Hester", written over a light blue circular stamp.

Thomas P. Hester, Jr.
Associate Counsel
Office of Inspector general
Legal Services Corporation

OFFICE OF INSPECTOR GENERAL

MEMORANDUM

TO: Ronald Merryman
Acting Inspector General

THROUGH: Laurie Tarantowicz
Assistant IG and Legal Counsel

FROM: Tom Hester
Associate Counsel

DATE: January 23, 2008

SUBJECT: Selection of Corporate Auditor

OIG has prepared this memorandum in response to the Board's request for background information about the Corporation's procedure for selection of an independent public accountant ("IPA" or "auditor") to perform the annual audit of LSC's financial statements.

A. Auditor Selection at LSC

Section 1009(a)(1) of the Legal Services Corporation Act, 42 U.S.C. § 2996 *et seq.* ("LSC Act"), requires the Corporation's accounts to be audited annually by an IPA. The audit is to be conducted in accordance with generally accepted auditing standards, and the resulting audit report is to be filed with the Government Accountability Office (formerly the General Accounting Office). *See id.* at § 1009(a)(1),(3). The LSC Act does not, however, specify who is to conduct the audit, or select and oversee the auditor.

Prior to 1992, the LSC Inspector General had no role in the selection or oversight of the IPA who performed the Corporation's annual audit. Instead, the Board selected an IPA from a list of best-qualified applicants developed by the LSC Comptroller. *See* 7/8/92 Memorandum from Victor Fortuno to Board of Directors. In March 1992, however, the Inspector General suggested to the Board

that the Inspector General Act contemplated an “active role for the OIG in the annual audit of the Corporation.” OIG Semiannual Report, April 1, 1992 to September 30, 1992, at 5. Ultimately, “with the assistance and cooperation of LSC’s Office of General Counsel and the Comptroller, the Inspector General demonstrated to the Board members that both the law and fiscal responsibility favored acceptance of an OIG role in the audit process.” *Id.* See also 3/27/92 Letter from Edouard Quatrevaux to Howard Dana (“No matter how hard the Comptroller may try, the audit firm sees him as LSC’s representative in the engagement process, the primary point of contact on audit issues, and as the source of their revenue. This is not to say that the audit was compromised in any way, but rather that it is poor policy for the auditee to appear to the auditor as the principal client representative.”)

As a result, in September 1992 the LSC Board adopted a resolution (the “1992 Resolution”) formalizing a new procedure for selection and oversight of the auditor. Under the new procedure, OIG was to issue a request for proposals for an audit and evaluate the responses from “both cost and technical perspectives.” 9/26/02 Resolution at 1. OIG was then to present the best-qualified bidders to the Board’s Audit and Appropriations Committee, which, in turn, would select the auditor. Subsequently, OIG was to provide guidance to the audit firm “through the contract and through participation in development of the engagement letter.” *Id.* In addition, OIG was charged with “solicit[ing] the concerns of the Audit and Appropriations Committee, and incorporate[ing] those concerns in developing areas of audit interest.” *Id.* Finally, OIG was to receive copies of all reports concerning audit and accounting issues the auditors encounter in the course of the audit; attend the Board meetings at which the audit’s results were presented; and track management’s progress in resolving any issues that the audit had brought to light. *See id.* at 2.

The Corporation did not long adhere to this procedure, however. By the mid-to-late 1990s, OIG had assumed sole responsibility for selecting the auditor. (Indeed, the Board no longer has an Audit and Appropriations Committee. *See* Transcript of 3/17/95 Board Meeting (resolution passed changing name of Audit and Appropriations Committee to Finance Committee)).

B. Statutory and Regulatory Background

Although the reasons for and precise timing of the shift of full responsibility to OIG for selection of the auditor are unclear, LSC's current practice is nevertheless in accord with the procedure statutorily required of virtually all entities which have a federal Inspector General.

At the time of the 1992 Resolution, Inspectors General were statutorily required to perform audits at only a limited number of federal entities. Under the Chief Financial Officers Act of 1990, 101 P.L. 576, 104 Stat. 2838, *codified at* 31 U.S.C. § 901 *et seq.* ("CFO Act"), certain federal agencies were required to prepare annual financial statements, which were to be audited by the agency Inspectors General, or by an independent external auditor "as determined by the Inspector[s] General." *Id.* at § 304(a). Covered agencies which did not have an Inspector General were to be audited by an independent external auditor "as determined by the head of the agency." *Id.*¹ In addition, the CFO Act amended the Government Corporation Control Act to vest Inspectors General at government corporations with the responsibility for auditing corporate financial statements. *See* 31 U.S.C. § 9105(a)(1) ("The financial statements of Government corporations shall be audited by the Inspector General of the corporation appointed under the Inspector General Act of 1978 [5 U.S.C. App.], or under other Federal law, or by an independent external auditor, as determined by the Inspector General or, if there is no Inspector General, by the head of the corporation.").²

¹ As it happens, the second clause of Section 304(a) was inoperative, as all agencies subject to the CFO Act had Inspectors General at the time of the law's enactment. *See id.* at § 205(a) (Act applies to all cabinet agencies; the Environmental Protection Agency; the National Aeronautical and Space Administration; Agency for International Development; the Federal Emergency Management Agency; the General Services Administration; the National Science Foundation; the Nuclear Regulatory Commission; the Office of Personnel Management; and the Small Business Administration). (As of 2002, FEMA is no longer independently subject to the CFO Act, but has been incorporated into the Department of Homeland Security, which itself is subject to the Act. *See* § 1701 of the Homeland Security Act of 2002, Pub. L. 107-296.)

² Although the Tennessee Valley Authority (TVA) is subject to the GCCA, a subsequently-enacted provision in the TVA Act directs the TVA Board's Audit Committee, in consultation with the TVA Inspector General, to recommend an external auditor to the TVA Board. *See* Section 2(g)(1)(I)(i) of the TVA Act, 48 Stat. 58-59, *codified at* 16 U.S.C. § 831 *et seq.* *See generally* *Hellon & Assocs., Inc. v. Phoenix Resort Corp.*, 958 F.2d 295, 297 (9th Cir. 1992) ("[I]n case of an irreconcilable inconsistency between [statutes] the later and more specific statute usually controls the earlier and more general one").

Since the 1992 Resolution, however, Congress has passed a number of statutes imposing the CFO Act's audit requirements on federal entities not covered by the CFO Act itself. For example, the Government Management Reform Act of 1994 ("GMRA") expands the audit requirements of the CFO Act by requiring certain components of agencies designated by OMB to prepare annual audits. *See* Pub. L. 103-356; OMB Bulletin No. 06-03, Appendix B (Aug. 23, 2006). Similarly, the Accountability of Tax Dollars Act of 2002 ("ATDA") requires all executive agencies not covered by the CFO Act to submit annual audited financial statements to Congress and the Office of Management and Budget. *See* Pub. L. 107-289; 31 U.S.C. § 3515(f)(1). *See also* 2 U.S.C. § 1903 (requiring Chief Administrative Office of Capitol Police to prepare annual financial statements, which are to be "audited by the Inspector General of the Capitol Police or by an independent public accountant, as determined by the Inspector General"); 7 U.S.C. § 2009aa-10(c) (requiring Inspector General of Department of Agriculture to perform annual audit of Delta Regional Authority); 7 U.S.C. § 136a-1(k)(5) (requiring EPA IG to perform annual audit of pesticide reregistration fund administered by agency).

In August 2006, moreover, OMB promulgated standards that apply to statutorily-required audits of all executive departments, agencies, and government corporations. *See* OMB Bulletin No. 06-03 (Aug. 23, 2006) ("Bulletin 06-03"). Under Bulletin 06-03, audits of the 24 CFO Act agencies are to be performed by agency OIGs, or by independent public accountants "as determined by the OIG." Bulletin 06-3, § 4.1. Audits of executive branch entities subject to the ATDA and the GCCA are likewise to be performed by the OIG, or by an IPA determined by the OIG. *See id.* § 4.2.³ These procedures are in accord with longstanding OMB policy that audit and investigative functions should, as a general rule, be carried out by agency OIGs. *See* OMB Memorandum for Head of Designated Federal Entities, Inspectors General of Designated Federal Entities, M-93-01 (Nov. 13, 1992), at 8.⁴

There is not a great deal of legislative history indicating why Inspectors General have been vested with the responsibility for administering audits of

³ If such an entity lacks an OIG, the audit is to be performed by an IPA as determined by management. *See id.* In addition, under the GMRA, the Comptroller General may, following consultation with the agency OIG, perform an audit himself. *See id.* §4.3.

⁴ Although OMB has designated the Corporation for Public Broadcasting as an entity subject to the ATDA, *see* 12/6/02 Memorandum for Heads of Selected Agencies, at 2, the CPB Inspector General plays only an advisory role in selection of the corporate auditor.

agencies and government corporations; the House Report on the CFO Act, for example, simply notes that Section 304 of the Act “reaffirms the statutory responsibility of the Inspector General of an agency to determine who shall perform the audit.” House Report 101-818, at 26. It should not be surprising that Congress vested the Inspectors General with this responsibility, however, as it was Congress’ manifest intent in the Inspector General Act of 1978, Pub. L. 95-452, 92 Stat. 1101, to consolidate 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”).

The IG Act’s legislative history indicates the decision to consolidate audit functions under the IGs was prompted by the same “inability or unwillingness [on the part of federal managers] to establish effective internal audit,” H.R. Rep. 771, *reprinted in* U.S. Code Cong. & Admin. News 3154, 3167, that later animated the CFO Act and other, related statutes, *see generally* 31 U.S.C. § 501(b)(3) (purpose of CFO Act is to “[p]rovide for the production of complete, reliable, timely and consistent financial information for use by the executive branch of the Government and the Congress in the financing, management, and evaluation of Federal programs”). This consolidation was conceived on a broad and comprehensive scale, and was intended to “provide for more independence for audit and investigative operations and [thereby] achieve more efficient and effective operations.” H. Rep. No. 771, 100th Cong., 2d Sess., at 5. *See also* IG Act § 4(a)(1)(IG is “to provide policy direction for and . . . supervise . . . and coordinate audits” of designated entity’s programs and operations); *id.* at (b)(1)(C) (IGs are required 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].” As the Senate Report on the 1988 IG Act amendments noted, “[w]ithout independence, and the appearance of independence, much of the audit function’s credibility is lost.” S. Rep. 100-150, at 8-9.⁵

⁵ *See generally* Government Auditing Standards 3.03, p. 27-28 (“In all matters relating to the audit work, the audit organization and the individual auditor, whether government or public, should be free both in fact *and appearance* from personal, external, and organizational impairments to independence.”) (emphasis supplied); Association of Independent Certified Public Accountants Statement on Auditing Standards 220.07 (2006) (“To emphasize independence from management, may corporations follow the practice of having the independent auditor appointed by the board of directors or elected by the stockholders.”).

Though LSC is not directly subject to the CFO Act and other statutes that mandate selection of the IPA by the Inspector General, it is subject to Congress' determination, expressed clearly in the IG Act, that consolidation of the audit function in the Offices of Inspectors General best comports with principles of sound financial management. As LSC management has acknowledged, "[t]he IG need[s] neither authority nor permission from LSC to conduct audits. The IG Act provides specific statutory authority [for such activity] [T]he Inspector General has considerably greater authority for audits and investigations under the IG Act than the Board could provide him under the Legal Services Corporation Act." Management Report to Congress on the Semi-Annual Reports Submitted By the Former Inspector General, September 30, 1989 – September 30, 1991, at 7 & n.28, quoted in 5/14/92 Memorandum from Counsel to the LSC Inspector General to LSC Inspector General, at 9.

C. Conclusion

In sum, while it does not appear to have been formally adopted by the Board, LSC's current practice with respect to selection of the corporate auditor is in accord with the prevailing, statutorily-based procedure required of virtually all entities with federal Inspectors General.