

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

LEGAL SERVICES CORPORATION
BOARD OF DIRECTORS

MEETING OF THE
FINANCE COMMITTEE

Saturday, January 26, 2008

10:39 a.m.

Legal Services Corporation
3333 K Street, N.W.
Washington, D.C. 20007

COMMITTEE MEMBERS PRESENT:

- Michael D. McKay, Chairman
- Lillian R. BeVier
- Thomas A. Fuentes
- Herbert S. Garten
- Thomas R. Meites (by telephone)
- Sarah M. Singleton
- Frank B. Strickland, ex officio

OTHER BOARD MEMBERS PRESENT:

- Jonann C. Chiles
- Bernice Phillips (by telephone)

1 STAFF AND PUBLIC PRESENT:

2 Helaine M. Barnett, President

Victor M. Fortuno, Vice President for Legal Affairs,
3 General Counsel and Corporate Secretary

Patricia D. Batie, Manager of Board Operations

4 David L. Richardson, Treasurer and Comptroller,
Office of Financial and Administrative Services

5 Mattie Cohan, Senior Assistant General Counsel

Charles Jeffress, Chief Administrative Officer

6 Ronald "Dutch" Merryman, Acting Inspector
General

7 Laurie Tarantowicz, Assistant Inspector General and
Legal Counsel, Office of the Inspector General

8 Joel Gallay, Special Counsel to the Inspector General,
Office of the Inspector General

9 David Maddox, Assistant Inspector General for
Management and Evaluation, Office of the
10 Inspector General

John Constance, Director, Office of Government
11 Relations and Public Affairs

John Meyer, Director, Office of Information Management

12

13 Deborah Hankinson, Chairman, SCLAID Committee, American
Bar Association (ABA)

14 Terry Brooks, American Bar Association (ABA)

Julie M. Strandlie, Director, Grassroots Operations/
15 Legislative Counsel, American Bar Association (ABA)

Linda Perle, Center for Law & Social Policy (CLASP)

16 Don Saunders, National Legal Aid and Defenders
Association (NLADA)

17 Julie Clark, National Legal Aid and Defenders
Association (NLADA)

18 Nancy Davis, WithumSmith+Brown, P.C.

19

20

21

22

1	.	Approval of agenda	5
2	.	Approval of the minutes of the committee's meeting of July 28, 2007	5
3	.	Approval of the minutes of the committee's meeting of September 17, 2007	5
4	.	Approval of the minutes of the committee's meeting of October 27, 2007	5
5	.	Presentation of the Fiscal Year 2007 Annual Financial Audit	7
7	p	Presentation by Dutch Merryman,	
8	p	Acting Inspector General	
9	p	Comments by Nancy Davis,	
	p	WithumSmith+Brown, P.C.	
10	.	Staff report on FY 2008 appropriations	54
	p	Report by John Constance	
11	.	Consider and act on locality pay	60
12	.	Consider and act on adoption of	
13		Consolidated Operating Budget for FY 2008	63
14	p	Presentation by David Richardsonp	
15	p	Comments by Charles Jeffress	
	p		
16	.	Presentation on LSC's financial reports for the first three months of FY 2008	68

1 . Consider and act on recommendation to the

2 board to establish an audit committee or

3 to assign audit committee functions to the

4 Finance Committee

71

5 p Presentation by Nancy Davis,

6 WithumSmith+Brown, P.C.

7

8

9

10

11

12

1

2

3

4

5

6

7

8

9

10

11

12

1

2

3

4

5

6

7

8

9

10

11

12

1

2

3

4

5

6

7

8

9

10

11

12

1

2

3

4

5

6

7

8

9

10

11

12

1

2

3

4

5

6

7

8

9

10

11

12

1

2

3

4

5

6

7 . Public comment 93

8 . Consider and act on other business 93

9 . Consider and act on adjustment of meeting 93

1 P R O C E E D I N G S

2 (10:39 a.m.)

3 CHAIRMAN McKAY: I call to order the meeting
4 of the finance committee.5 The first item on the agenda is approval of
6 the agenda.

7 M O T I O N

8 MR. FUENTES: Move approval.

9 CHAIRMAN McKAY: Do I hear a second?

10 MR. GARTEN: Second.

11 CHAIRMAN McKAY: All those in favor, say aye.

12 (A chorus of ayes.)

13 CHAIRMAN McKAY: Opposed?

14 (No response.)

15 CHAIRMAN McKAY: Next three items on the
16 agenda are approval of the minutes of the committee's
17 meetings on July 28th --

18 M O T I O N

19 MR. FUENTES: Move approval by one motion of
20 the three.

21 MR. GARTEN: Second.

22 CHAIRMAN McKAY: All those in favor say aye.

1 (A chorus of ayes.)

2 CHAIRMAN McKAY: Opposed?

3 (No response.)

4 CHAIRMAN McKAY: Fifth item on the agenda is
5 presentation of fiscal year 2007 annual financial
6 audit. We're going to hear from Dutch Merryman and
7 Nancy Davis.

8 Welcome to you both. Please identify
9 yourselves for the record.

10 MR. MERRYMAN: Okay, Mr. Chairman. Thank you
11 very much, and members of the committee. My name is
12 Ronald Merryman. I'm the acting inspector general for
13 LSC. And with me is Nancy Davis. I'll let you --

14 MS. DAVIS: I'm Nancy Davis. I'm a partner
15 with WithumSmith+Brown. Our offices are located in
16 Silver Spring, Maryland.

17 CHAIRMAN McKAY: Thank you.

18 MR. MERRYMAN: We're here to present the
19 results of the FY 2007 financial statement audit
20 report. I have forwarded each member of the board a
21 copy of the report through a transmittal letter. I
22 will defer to Nancy to give the full briefing on the

1 report and contents, and be prepared to answer any
2 questions that you may have. So Nancy?

3 MS. DAVIS: All right. Good morning to all of
4 you.

5 MR. STRICKLAND: Nancy, you might want to pull
6 the microphone closer to you so the people on the
7 conference call can hear you.

8 MS. DAVIS: All right. This year, the audit
9 was performed very smoothly. I think that we had some
10 delays last year, and so at the inception of the audit
11 this year, there was a real concurrence between
12 management and the IG and the auditors as to the
13 schedule and how we would move forward to ensure a
14 timely delivery of this report.

15 And I believe that did occur. There was real
16 tight communication amongst all the parties to ensure
17 that the information that was needed to complete the
18 audit was provided in a timely way so it could be
19 processed. So I believe that the audit itself this
20 year went very well.

21 There were not any significant changes in the
22 financial reporting and accounting function within the

1 agency, no significant change in systems or policies
2 and procedures in terms of how things were handled. So
3 we again tested things thoroughly and again issued an
4 unqualified opinion on your financial statements. I
5 feel that Dave Richardson does an exemplary job in what
6 he does, and he's very much on top of it. So again,
7 things went very well.

8 This year we issued one finding that we
9 identified as a significant deficiency. I don't know
10 if you all have a copy of the annual report or not.
11 But at the very back of the report, the last two pages
12 of the report, it's on letterhead.

13 That report at the end of the annual report is
14 what we call a Yellow Book report. Under government
15 auditing standards, we're required to perform tests of
16 compliance and internal control. We are not issuing an
17 opinion on compliance and internal control. The
18 extensiveness of testing is not to the end that we have
19 enough audit evidence to do that. But we are required
20 to test it.

21 And in that testing, we identified one
22 incident. It was a nonrecurring event that took place.

1 There had been a settlement reached with a grantee, a
2 property settlement with a grantee. LSC expected those
3 funds to be returned to them. The organization did
4 have knowledge that those funds would be coming back.

5 But they were received after September 30, and
6 they were recorded on a cash basis at the time the cash
7 came in. And accounting standards require that if,
8 prior to the end of the fiscal year, you're
9 knowledgeable that such an event has taken place and it
10 can be quantified, that it needs to be accrued at
11 September 30.

12 We were performing subsequent procedures on
13 the financial activity after September 30, and that's
14 where we identified this unusual cash receipt. It
15 qualifies here, in our opinion, as a significant
16 deficiency simply because it is a material amount to
17 your financial statements. So under the pure
18 accounting standards, its not being recorded as of
19 September 30 would have caused your financial
20 statements not to be fairly presented.

21 I don't see this -- as much as that sounds
22 like a big issue, it's not as significant as it might

1 seem. This was a nonrecurring event -- not that the
2 event doesn't occur for you all, but in terms of it's
3 not an everyday operational transaction.

4 And having spoken to President Barnett, she's
5 indicated that the corrective action has now been put
6 in place to ensure that the accounting operation is
7 knowledgeable of these settlements at the time that
8 they have been reached so that the proper recording can
9 be done.

10 So that's the nature of the finding that we
11 did, the one finding that is included in the annual
12 report here.

13 CHAIRMAN McKAY: And with regard to that
14 finding, you indicate a corrective action has been
15 made.

16 Have you seen a copy of a memorandum dated
17 January 2, 2008 from Mr. Jeffress to Mr. Fortuno on
18 that subject?

19 MS. DAVIS: Yes.

20 CHAIRMAN McKAY: Very good. And you're
21 satisfied with that response?

22 MS. DAVIS: Yes. And as auditors, then, we

1 would consider the finding, the status of the finding,
2 resolved but not closed. In a subsequent audit, we
3 would go in and then test to see if in fact that
4 corrective action had been effectively implemented, and
5 then at that time close the finding.

6 CHAIRMAN MCKAY: I'd also like you to comment,
7 if you could, briefly on the management letter, which
8 is the separate piece of paper that's on Ms. Davis's
9 letterhead. You address at the bottom of the first
10 page prior year recommendations. And at the very last
11 paragraph you indicate that in fiscal year 2007, you
12 had noted that management had removed obsolete items
13 from its inventory, and no similar errors were noted in
14 the transactions we tested.

15 And we as a committee heard you bring that to
16 our attention in previous years. And while you weren't
17 in attendance at those subsequent meetings, we did ask
18 Mr. Richardson -- who by the way I think is doing an
19 outstanding job as well, by the way -- did address the
20 concern that you raised.

21 And we checked in on it every once in a while,
22 and we're pleased to see that you made that

1 observation; that is, that you've come and validated
2 that that issue that you had identified previously is
3 no longer a problem.

4 MS. DAVIS: Correct.

5 CHAIRMAN McKAY: So again, we thank you very
6 much.

7 Do members of the committee or anyone else
8 have questions of Ms. Davis?

9 (No response.)

10 CHAIRMAN McKAY: Mr. Merryman?

11 MR. MERRYMAN: That concludes the portion on
12 presenting the annual report to the committee, sir. We
13 do have some other issues to discuss with the committee
14 dealing with the new standards, the standard 114.

15 CHAIRMAN McKAY: That's a little later on the
16 agenda, I believe -- no, actually, you're right. We
17 should be addressing that right now. And so if you
18 could go on and discuss that, I'd appreciate it.

19 MS. DAVIS: When I met with you all last year,
20 I indicated that there were a significant number of
21 changes that were in the pipeline that would be coming
22 your way. And so this year, as I appear before you

1 all, to inform you that those changes are now on your
2 doorstep. There will be some significant changes in
3 fiscal year 2008 as it relates to the audit. And it's
4 important that I inform you as to what those changes
5 will be.

6 I think that last year and this year, between
7 these two years, there are now ten new auditing
8 standards that have become effective. I do not
9 remember in my career a year when there have been that
10 many auditing standards to hit all at one time. That's
11 unusual.

12 Again, this started out as a result of the
13 fallout at Enron; subsequently, the formation of the
14 PCAOB and some very rigorous auditing standards that
15 were put into place to address the audit of public
16 corporations.

17 Those things have, since that time, trickled
18 down. The GAO has stepped up in a proactive way to be
19 responsive within the federal arena to implement new
20 and more rigorous auditing requirements for those that
21 manage and oversee federal funding.

22 Last year there was a 2007 version of

1 government auditing standards known as the Yellow Book
2 that was issued. The Yellow Book incorporates by
3 reference the AICPA standards. The new Yellow Book
4 revision also has stepped up their emphasis on quality
5 control over the audit process, the importance of
6 ethics in the performance of audits. And so again a
7 real rigorous standard is being -- has been set forth
8 by GAO for compliance by the federal government.

9 Also along the same track but on the
10 management side, there's been a similar effort, the
11 Sarbanes-Oxley bill, as perhaps some of you are
12 familiar with.

13 The 404 provision has required that the public
14 corporations institute a process for documenting and
15 assessing and testing internal controls to the end that
16 they have an audit done of the effectiveness of those
17 internal controls. To date, it's only applicable to
18 accelerated filers. It's still to be implemented to
19 the non-accelerated filers.

20 Again, in a trickle-down process, the federal
21 government followed suit, and a couple of years ago
22 they beefed up, if you will, the OMB Circular A-123

1 entitled, "Management's Responsibility for Internal
2 Control." And there's an Appendix A that is now
3 attached to that circular that effectively, for the
4 large 24 CFO Act agencies in the government, they are
5 now required -- management is now required to implement
6 a process very similar to what the SOX 404 provision is
7 for the accelerated filers. It's just that within the
8 government, they stopped short of requiring an opinion
9 on those internal controls.

10 So a couple of years ago, the federal agencies
11 were scrambling, the CFO offices, to implement the
12 requirements under Appendix A. And that has required
13 them documenting their internal control processes,
14 testing the internal controls, reporting, issuing a
15 statement of assurance in their performance and
16 accountability reports by management as to the reliance
17 that can be placed on those controls. What assurance
18 is management giving in terms of the effectiveness of
19 the controls?

20 And I think it's important for you all to
21 understand some of the broad picture of the environment
22 in which LSC is operating because I think that in

1 reading the GAO reports, on the whole I understand, and
2 particularly in the governance one agree with their
3 recommendations on the whole. But I think I am reading
4 it perhaps with a little bit different perspective
5 because I understand sort of the arena in which they're
6 operating and some of the perspective with which
7 they're looking at things.

8 So what's now happened is that there was a
9 lot of discussion as to how these same types of
10 standards in terms of audit quality and management's
11 responsibility for internal controls should trickle
12 down to the small businesses and not-for-profits. And
13 there's been lots and lots of discussion.

14 So what we are experiencing now with the
15 issuance of these ten new auditing standards is the
16 result of all of that. These auditing standards now
17 are applicable to all entities, small business, the
18 nonpublic entities, not-for-profits. And as I
19 indicated, they're incorporated by reference into the
20 Yellow Book, and therefore are also applicable to
21 audits within the federal government.

22 So this is now a much -- what it has done now

1 is established a much more rigorous standard for the
2 way audits are to be conducted. They issued these
3 standards with a future effective date quite a ways out
4 because it was going to take IPAs quite a bit of time
5 to figure out the best way to implement these
6 standards. So it is effective for audit periods
7 beginning on or after December 16, 2007 -- 2006, excuse
8 me. So for fiscal year 2008, it is applicable for
9 Legal Services Corporation.

10 MR. MEITES: Mike, can I ask a question?

11 MS. DAVIS: Yes.

12 MR. MEITES: Besides us, these would also
13 apply to our grantees, wouldn't they?

14 MS. DAVIS: They apply to any financial
15 statement audit that's being performed. Correct.

16 MR. MEITES: Our grantees are not-for-profit
17 corporations.

18 MS. DAVIS: That's correct.

19 MR. MEITES: So they would also be subject to
20 these ten additional audit points. Correct?

21 MS. DAVIS: That's correct.

22 MR. MEITES: So our independent auditors are

1 going to have to master these and apply them to our
2 140-plus grantees. Correct?

3 MS. DAVIS: That's correct. I also would like
4 to share in that context, too, that the federal
5 government has always had a concern about audit
6 quality. But it's not just simply focused on audit.
7 But they were concerned about the -- there's been some
8 discussion over the years about the effectiveness of
9 the single audit process.

10 The Single Audit Act was put into place to
11 provide a mechanism whereby the federal agencies that
12 disburse billions of dollars to grantees would be able
13 to have a mechanism by which they could obtain some
14 assurance as to how those funds are being used. That
15 would mean that the agencies, all the agencies
16 themselves, would not have to go in and perform their
17 own audits. It would be a single audit that all the
18 government agencies could rely on.

19 There's been some question in recent years
20 about the nature of the audit quality. That has come
21 out of that single audit process. The federal agencies
22 have to rely on the results of that process when they

1 issue opinions on their financial statements.

2 So what came out of that was a single audit
3 project that was performed by the Department of
4 Education, and they issued a report last summer in
5 terms of the results. What they did under that project
6 was that they went out and audited several hundred
7 single audits that had been performed by IPAs. They
8 reviewed the work papers associated with those audits.
9 And they came back and have proposed some
10 recommendations on how the process can be strengthened.

11 I anticipate now that that will be -- when
12 they have worked through those discussions and made
13 some decisions as to how they can strengthen the
14 process, that there will then be new requirements.
15 There will be -- A-133 under which these audits are
16 performed, will become more robust.

17 I think that there will be strengthened
18 requirements for the qualifications of those IPAs that
19 perform these types of audits. So I think the
20 government right now is already being very proactive to
21 address those issues.

22 So as it relates to the audit function,

1 auditors have been -- we're getting it all the way
2 around, whether it's from the auditing standards,
3 whether it's from the Yellow Book standards, the
4 government auditing standards; in the future, perhaps,
5 with increased standards under the A-133 Single Audit
6 Act.

7 And so the view long-term is that those of you
8 that rely on audits, either financial statement audits
9 or audits of federal funds, can have more assurance in
10 terms of the nature of those audits and what you're
11 reading in terms of what the results of those audits
12 are providing to you.

13 MR. MEITES: And again, you'd anticipate the
14 ultimate outcome of the work that you indicate as being
15 done by the Department of Education would trickle down
16 to the independent auditors who audit our grantees?

17 MS. DAVIS: Yes. It will be -- what will
18 happen is that there will be a reservation in the OMB
19 Circular A-133, and the additional guidance and
20 requirements will be -- OMB will put out that guidance
21 through that vehicle.

22 MR. MEITES: Thank you very much.

1 CHAIRMAN McKAY: Thank you. I'm wondering,
2 unless there are any other questions, that you could
3 spend a moment or two talking about SAS 114. You
4 prepared a document the first page of which summarizes
5 it, and we've handed out to the members of the
6 committee and members of the board.

7 If you could spend a moment talking about
8 that. Obviously very important. You alerted us to
9 this a year ago. You, through Mr. Merryman, arranged
10 to have us receive a copy of this last March, and I'm
11 sure we've all read it and studied it.

12 But we've been working in anticipation of this
13 meeting today for a year because you've alerted us to
14 this. So we do appreciate that. We appreciate your
15 work on the summary. But if you could go through the
16 summary for us --

17 MS. DAVIS: I will.

18 CHAIRMAN McKAY: -- and kind of sensitize us
19 to what this means going forward with regard to our
20 role as we work with you.

21 MS. DAVIS: Right. And so what I wanted to do
22 this morning is to share with you, there are eight

1 auditing standards here that will have a direct impact,
2 plus this SAS No. 114. That has a very targeted impact
3 on those charged with governance.

4 So that I can bring you up to speed with what
5 some of these requirements are, I don't plan to go into
6 a lot of tedious detail with it. Certainly those
7 standards are out there if you have a desire to look at
8 the details more often. But I want to give you sort of
9 a big picture so you can anticipate what is now in
10 place.

11 Under SAS No. 114, "The Auditor's
12 Communication with Those Charged with Governance," the
13 standard provides guidance on the auditor's
14 communication with those charged with governance in
15 relation to an audit of financial statements. It's
16 very targeted in that respect.

17 And the objective of the standard is to
18 communicate matters related to the financial audit that
19 are, in the auditor's professional judgment,
20 significant and relevant to the responsibilities of
21 those charged with governance and overseeing the
22 financial reporting process.

1 This standard supersedes SAS No. 61 that was
2 titled, "Communication with Audit Committees." That
3 standard was targeted very much to the auditor
4 communicating to an audit committee, but not every
5 organization has one. So this new 114 has expanded
6 that to address the auditor's communication to those
7 charged with governance, which is a much broader
8 definition.

9 CHAIRMAN MCKAY: And you and I, by the way,
10 had a very productive meeting yesterday, and I
11 appreciate your time. And so I have a bit of a head
12 start here.

13 But could you just comment briefly on what
14 that -- give an example of what that would mean? For
15 instance, when you have the entrance interviews and the
16 exit meetings, no one from the board would participate
17 in those meetings.

18 What would you envision with regard to the
19 board's involvement going forward?

20 MS. DAVIS: What these standards will do as
21 they are implemented will change the working
22 relationship between those charged with governance,

1 with management, and with the external auditors. Those
2 charged with governance, as well as management and the
3 auditors, are being asked to, if you will, take a step
4 up in terms of the quality and the scope of the
5 responsibilities they assume as it relates to an audit
6 of financial statements.

7 So while there has been -- their communication
8 has existed between the auditors and a board,
9 historically that has amounted to appearing in front
10 of the board at the back end of the audit for the
11 purpose of reporting on the audit results.

12 What these standards are designed to do is to
13 engage those charged with governance in a more active
14 way in the process; that it moves, if you will, away
15 from the board saying, well, we didn't know that was
16 going on because management didn't tell us. It's now
17 saying to those charged with governance, you have a
18 responsibility to engage in the process.

19 So I see this most effectively happening that
20 you all are under discussion in terms of the role of
21 the board and the IG in the selection of the IPA for
22 the financial statement audit here at LSC. Going

1 forward then, you move into the planning phase of the
2 audit. We start an audit each year with an entrance
3 conference. Management, the IG, and the auditor are
4 present there.

5 I believe that it would be prudent now under
6 these new requirements that a member of an audit
7 committee type entity, whoever you all deem that to be,
8 that someone would be present for that purpose and be a
9 part of the discussions of what is expected in the
10 audit.

11 During the course of the audit, it is always
12 our policy that as there are any issues to be
13 identified or any difficulties in the execution of the
14 audit, we certainly report that promptly to the IG and
15 to management so we're all on the same page. And now I
16 would see that the board would also be brought into
17 that loop and in that sense be an active participant.

18 At the back end, we hold an exit conference
19 where we sit down and discuss and sort of go over the
20 results of the audit. But we discuss things like
21 lessons learned, things that we can improve on the
22 process going forward as we did last year to implement

1 a better practice this year. And I believe that it's
2 very important that a member of the board be present
3 for that exit conference as well.

4 So in that regard, that those charged with
5 governance would be an active participant in the audit
6 process, would be able to ask questions, and it would
7 provide a stronger oversight mechanism for the board in
8 terms of the audit that is conducted here at LSC.

9 CHAIRMAN McKAY: Thank you.

10 MS. SINGLETON: Can I ask a question about
11 that?

12 CHAIRMAN McKAY: Please.

13 MS. SINGLETON: Do you think it impacts the
14 auditor's ability to communicate with the governing
15 body if it's some entity other than the governing body
16 that actually hires and contracts with the auditor?
17 Selects the auditor, is basically what I'm --

18 MS. DAVIS: I don't for me personally know. I
19 don't see that to be an issue. I think that in my
20 opinion, I think it should be a collaborative process.
21 I think the board does have an oversight interest
22 there. But I also believe that the inspector general's

1 office has a technical expertise and knowledge that
2 perhaps the board may not have. And so I think there
3 really is -- there's a reliance that both -- or there's
4 a role that both parties play in the process.

5 MS. SINGLETON: And you don't feel -- I mean,
6 assuming -- is there any time limit on how long a
7 person or a group could be an auditor?

8 MS. DAVIS: No. You know, post-Enron there
9 were talk about mandatory rotations, and I think
10 they've gotten past that. I think that it's -- at that
11 point I think it is a decision of the board to decide
12 when they feel that it would be in the best interests
13 and when perhaps they need a fresh perspective or would
14 like one. But there is no mandatory requirement.

15 MS. SINGLETON: And you don't believe that if
16 in fact there is a management or an IG-level entity
17 who is out actually contacting auditors, making
18 recommendations to the board, you don't feel as though
19 that would make the auditor be more loyal to that
20 entity rather than the board?

21 MS. DAVIS: I don't function that way, no. I
22 mean, the board is responsible for the entity. So I

1 don't feel that.

2 CHAIRMAN MCKAY: Herb?

3 MR. GARTEN: Your report refers to all the
4 programs that exist around the country. And to what
5 extent do you rely on the independent CPA reports in
6 issuing your report?

7 MS. DAVIS: We don't, in the sense of our
8 issuing our opinion over the financial statements
9 themselves. We do, in compliance with the Yellow Book,
10 do some testing of internal controls in compliance.
11 And we look at the review of the single audit process
12 that takes place here.

13 That is the mechanism in place for oversight
14 of the IPA single audits, is the receipt of all those
15 single audit reports here by the IG and their review.
16 And we've tested to see what it is they look at, how
17 this is handled, how it flows through LSC. And we have
18 looked at that every year.

19 MR. GARTEN: And it's part of your file that
20 you maintain. Have you found anything that troubles
21 you with respect to any of these independent reports?

22 MS. DAVIS: No, we haven't. I mean, I think

1 that the way the single audit process works is that
2 under the guidance of a 133, there is a way that an
3 auditor makes a selection of the programs to be audited
4 at an entity. And so based on that selection of
5 programs, an LSC grant may or may not be selected for
6 testing at that grantee.

7 So when single audit reports are received, not
8 only by LSC or by any federal agency, what they are
9 going to be looking for is to see if there were any
10 findings that would be applicable to their funding,
11 both in a specific way or perhaps in a large-scale way.
12 If the general internal controls of the entity are not
13 effective, then that could have an impact on a
14 particular grant. And we look for questioned costs
15 that might have been identified if that grant had been
16 audited.

17 But having performed audits of grants on
18 behalf of federal agencies where single audits also
19 have been conducted, generally the single audit auditor
20 is dealing with materiality levels that may be
21 significantly higher, and that an entity's program may
22 not be picked up every year. It may not be identified

1 as a major program for the purpose of testing.

2 So it's not that the -- the IPA may be very
3 well complying with the requirements under A-133. But
4 LSC grant funding in the particular may not be selected
5 for testing in a given year.

6 MR. MERRYMAN: No. I do have to correct that.
7 It is required by law that every grantee -- Laurie?
8 Oh, I'm sorry.

9 MS. TARANTOWICZ: Laurie Tarantowicz, OIG
10 counsel. All of our grantees receive -- their funds
11 are audited -- LSC funds are audited on an annual
12 basis. Although the audit requirements are similar in
13 most respects to those under the Single Audit Act, we
14 actually don't come under the Single Audit Act or
15 A-133. So the OIG issues guidance and has ensured
16 that, each year, the LSC funds of every grantee is
17 audited -- are audited.

18 MS. DAVIS: Yes. There are additional
19 requirements.

20 MR. GARTEN: In connection with your audit,
21 you're reviewing each of these independent audit
22 reports?

1 MS. DAVIS: We're reviewing the OIG's review
2 of those reports, as well as the content, obviously,
3 that's there. But yes, we're reviewing that, and the
4 compliance with --

5 CHAIRMAN McKAY: Sarah?

6 MS. SINGLETON: I think I need it to be a
7 little bit more concrete for me to understand it. You
8 said you read the GAO reports?

9 MS. DAVIS: Yes.

10 MS. SINGLETON: You did? Do you remember the
11 problem with the booking the money, the earnest money,
12 that was forfeited by one of our grantees, and they
13 booked it to a non-LSC account even though apparently
14 that building had been purchased with some LSC money?
15 Do you remember that? \$280,000 or something along
16 those lines?

17 MS. DAVIS: Yes. I remember the comment. But
18 that's outside the purview of the compliance that we
19 would be addressing.

20 MS. SINGLETON: Well, that's what I wanted to
21 ask. You mentioned internal controls, and I'm not
22 quite clear on what those are. But who should have

1 picked up, if anybody, the fact that that grantee had
2 mis-booked the earnest money forfeiture when it came
3 into their shop?

4 MS. DAVIS: Management of the grantee. They
5 should have internal controls in place to have caught
6 that.

7 MS. SINGLETON: All right. And so let's say
8 they didn't because they're the ones who booked it in
9 the wrong place. Who should have picked up that
10 management didn't do it right? Should their IPA?

11 MS. DAVIS: It depends on the nature of the
12 dollar amounts involved. When you select on a sample
13 basis, they may or may not have selected it for
14 testing.

15 MS. SINGLETON: Dutch, do you remember
16 whether -- in the context of that particular program
17 whether it was sizeable enough that it would have been
18 material?

19 MR. MERRYMAN: I personally believe it would
20 have been. It's in the \$200,000 range.

21 MS. SINGLETON: Right.

22 MR. MERRYMAN: But what I don't know is the

1 timing. I don't know if certain events
2 occurred -- because it was held in escrow, first of
3 all; and then it was a contract that was defaulted on,
4 for lack of a better term; and then it was recorded.

5 I don't know where the IPA came into the
6 process at. That's part of trying to get the fact
7 pattern. Because it could have been booked if the IPA
8 hadn't got there yet to take a look at that because
9 they come at the end of the year. So I don't know yet.
10 But we're going to find out.

11 MS. SINGLETON: Okay.

12 MR. MERRYMAN: But I would expect something
13 like that to be caught.

14 MS. SINGLETON: By the IPA?

15 MR. MERRYMAN: By the IPA.

16 MS. SINGLETON: All right. So let's just take
17 that as a given, based on what Dutch has said. If the
18 IPA didn't catch it, is there any way that somebody
19 here at LSC should have caught the fact that the IPA
20 didn't catch it?

21 MS. DAVIS: I think that based on the type of
22 oversight you currently have in place, you wouldn't

1 have. I think that you would have to just -- you'll
2 have to have an oversight function that goes beyond
3 where you are now.

4 MS. SINGLETON: And I guess I have two
5 questions. Are we required by law to have an oversight
6 function that goes beyond where we are right now, law
7 or accounting principles? Or if we're not required to,
8 should we have such an oversight?

9 MS. DAVIS: I don't think there's a
10 requirement per se. I think that management is charged
11 with the responsibility for internal controls in the
12 organization, period. And so whatever then management
13 deems is necessary in order to ensure that there are
14 effective controls, they need to put that type of an
15 oversight mechanism in place to do that.

16 MS. SINGLETON: And when you say management,
17 you're talking technically about LSC management, as
18 opposed to the IG's office? Or not? Maybe you're not.
19 I don't know.

20 MS. DAVIS: No. I mean, technically it's
21 management's responsibility. But it also has to do
22 with the designation of that responsibility within your

1 organization. You have to understand, you all are
2 unique in that you have an IG function as a
3 not-for-profit. So that's a little bit different.

4 MS. SINGLETON: I'm still having a real hard
5 time getting my hands around how we would find out that
6 the independent public accountant for our grantee blew
7 it.

8 CHAIRMAN McKAY: This is a very difficult but
9 also an important issue.

10 MS. DAVIS: Right.

11 CHAIRMAN McKAY: Obviously a GAO-related
12 issue. And this committee and ops and regs committee
13 certainly this weekend cannot drill as deep as these
14 issues deserve to be attended to.

15 And so while I don't want to certainly cut
16 off -- I cannot cut off any member of the committee or
17 the board, let me just suggest that as important as
18 this issue is, that this be addressed by the ad hoc
19 committee, assuming the board approves it, because it
20 is so important.

21 And we have a lot to do today. But at any one
22 time, any time a committee member wants to drill, let's

1 do it. But I would encourage us to recognize it's a
2 big issue, embrace it, and then to make sure it's on
3 the list for the ad hoc committee because it clearly
4 should be, in my opinion.

5 MS. SINGLETON: I stand duly reprimanded.

6 (Laughter)

7 CHAIRMAN McKAY: Then it was miscommunicated
8 because it certainly is not a reprimand at all.

9 MS. BeVIER: Can I just interrupt? I
10 apologize for repeating. It's not only should be, but
11 this is precisely that -- it's an issue of principle.
12 How duplicative is management supposed to be? And that
13 is a huge decision for us in terms of allocation of
14 resources and fulfilling our responsibilities.

15 MS. DAVIS: Right. Exactly. Well, and I have
16 to tell you the federal government is going through the
17 same thing because they are required to rely on the
18 single audit. If they do not, then they have to have
19 their own resources to go out and perform the audits
20 themselves. So it's a big problem for a lot of -- it's
21 not just you all.

22 MR. GARTEN: And from our standpoint, we're

1 wondering whether we can rely on your audit.

2 MS. DAVIS: That's true.

3 CHAIRMAN McKAY: And you should be consoled
4 that one of the issues I raised with Ms. Davis
5 yesterday was her availability to assist us, the ad hoc
6 committee or whoever, on addressing these issues going
7 forward and not waiting for her to show up next
8 October 1 to address the audit. Because I think she's
9 a wonderful resource, and I'm hoping that the ad hoc
10 committee does that.

11 MS. DAVIS: But you all do have within your
12 purview, and it would be particularly applicable to the
13 IG, to review the work papers of those IPAs. I mean,
14 that is one where you could put some emphasis.

15 MR. STRICKLAND: Mr. Chairman, may I ask one
16 question?

17 CHAIRMAN McKAY: Yes. Of course.

18 MR. STRICKLAND: With respect to the -- let's
19 assume for discussion that all of our 137 grantees turn
20 in on a timely basis an audit prepared by an IPA for
21 that program. Are you aware, are either of you aware,
22 of a single instance when that report has been anything

1 other than an unqualified opinion?

2 MR. MERRYMAN: I am aware, yes.

3 MR. STRICKLAND: So there are instances where
4 they are qualified opinions?

5 MR. MERRYMAN: There are instances where there
6 are disclaimers of opinion, too, which means there was
7 not enough evidence to render an opinion, like lack of
8 documentation, documentation missing. In our recent
9 grantee that has been defunded, there were reports of
10 disclaimer of opinion, that financial statement
11 information could not be -- so there are instances of
12 that. Not high frequency, but there are instances of
13 it.

14 CHAIRMAN McKAY: And in those instances,
15 whatever the number might be, I presume -- or tell me
16 if I'm correct that when you see those, your office
17 takes some additional steps immediately. Is that a
18 fair statement?

19 MR. MERRYMAN: We will contact the IPA to try
20 to make sure we understand exactly what had happened.
21 Usually we have a very good understanding. It deals
22 with -- the information is just not supportable that

1 was presented to them. They cannot find -- we had
2 been, in the past, using a system called -- and we
3 still are -- AIMS that -- in addition to sending a copy
4 of the report down to OCE. But what I have discovered
5 in discussions with Karen is that there's been no flag
6 in that system specifically to say, this is an issue.

7 We have changed that process starting at the
8 beginning of the summer to transmit those reports
9 separately, flag it into the system separately, put a
10 cover letter on it to make sure that OCE and everybody
11 realizes this is a problem area. This is a situation
12 that needs to be addressed.

13 And so we are trying to make sure those things
14 are highlighted, everybody's aware of it, and then
15 appropriate action can be taken to see what the issue
16 is. Why isn't there documentation? Why is there a
17 disclaimer of opinion? What is going on with the
18 grantee?

19 MR. STRICKLAND: What I'm trying to get from
20 you is some assurance that when those situations occur,
21 there is some immediate follow-up, either by your
22 office or by OCE or both.

1 MR. MERRYMAN: Yes. There's immediate
2 communication. It's brought to my attention
3 immediately so we can start seeing what actions need to
4 be taken. If there's no documentation or something
5 like that, we do -- of the grantee, usually the grantee
6 does not have the documentation. We do look at those.

7 MR. STRICKLAND: Is it also the case that if
8 you get from a grantee program a clean opinion, that
9 there is no further follow-up with respect to that
10 audit?

11 MR. MERRYMAN: Not necessarily. What we do is
12 we have a checklist that we go through to make sure
13 that the report has the contents, the information,
14 contained in that. And if we have anything that either
15 does not make sense, does not -- to that process, if we
16 have any questions, we contact the IPA for
17 clarification.

18 So we don't just say, clean opinion, off to
19 the side, don't look at it. We look at every report
20 that comes in. We put it through a checklist process
21 to make sure that it has certain information that is
22 required. We look for unusual things, footnotes that

1 may say everything's okay but it sounds out of the
2 ordinary.

3 For instance, the issue about the escrow
4 payment, if there was a footnote, we would have said,
5 that's unusual. What is going on here? So if it was
6 in the statements, we might have questioned it. We
7 have not --

8 MR. STRICKLAND: And what are the professional
9 qualifications of the individuals in your office who
10 perform that review?

11 MR. MERRYMAN: Well, the initial review is
12 done by the audit technician through a checklist, our
13 checklist. And then it's referred to -- I have five
14 fully qualified auditors, four of whom are CPAs.

15 MR. STRICKLAND: Okay. Good. Thank you.

16 MR. GARTEN: We've had comments and testimony
17 in the past with regard to a concern about whether
18 these independent CPAs were qualified and were familiar
19 with the laws that are applicable to Legal Services
20 Corporation.

21 What if anything has been done in checking to
22 make sure that these independent firms are competent

1 and able to issue an opinion?

2 MR. MERRYMAN: On the compliance side?

3 MR. GARTEN: Yes.

4 MR. MERRYMAN: The compliance supplement has a
5 summary of all the regulations that are subject to
6 review. Unfortunately -- well, not
7 unfortunately -- the regulations usually change very
8 little over time, and some of these summaries have been
9 in there since the inception in '96.

10 And we are updating more summaries so that we
11 do provide a summary and information on the law, on the
12 meaning of the law, and suggested steps on how to test,
13 in the compliance supplement.

14 And as we see needs to change it, we want to
15 really try to do a more extensive revamp. But as we
16 see a need to change the steps, we change the steps and
17 put it into the compliance supplement, which they are
18 supposed to follow.

19 MR. GARTEN: It's been suggested that perhaps
20 you ought to supply members of the board with a copy of
21 that.

22 MR. MERRYMAN: I will, yes. It's posted on

1 our website, but I'll get a copy.

2 MR. GARTEN: Well, have you run into any
3 situations where it's been determined that the
4 independent CPAs in their reports have not been aware
5 of what they're supposed to do in addition to the
6 regular auditing standard?

7 MR. MERRYMAN: We have -- from time to time
8 have issues on the additional standards required by
9 government auditing standards dealing with
10 documentation. We have had some times where the steps
11 were not followed.

12 But it's not like rampant. We address those
13 issues at the time with the IPA, either request them to
14 go back and do the work completely or, if they're in
15 the process of doing the audit, the next audit, is to
16 make sure that the new cycle is being done correctly,
17 and supply us with the information and the work papers
18 that support that. And so we try to take corrective
19 action wherever we see it.

20 The law provides for debarment, and there is a
21 debarment regulation should we get to the point where
22 the IPA is not doing what we ask them to do and

1 corrective action is not -- and rises to the level of
2 going through a process of actually debarring an IPA
3 from doing further work for LSC. It's not been
4 exercised.

5 MR. GARTEN: As part of your audit, do you
6 check to see whether they are following through with
7 respect to these independent --

8 MS. DAVIS: Yes. They say -- the IG said,
9 this is our process for overseeing the single audit
10 reports. This is our mechanism for overseeing the
11 IPAs. And we test their compliance in following
12 through -- their checklists, what they do with the
13 documents, whatever, and they do what they say they're
14 doing. And to that end, they are compliant with the
15 existing procedures.

16 MR. GARTEN: That's reassuring. Thank you.

17 MR. MERRYMAN: Well, we can always look for
18 improvement, though, sir, in everything that we do.

19 MS. DAVIS: Right.

20 CHAIRMAN MCKAY: And that will surely be
21 discussed by our ad hoc committee.

22 (Laughter)

1 CHAIRMAN McKAY: If there aren't any other
2 questions, we'll move on. Thank you. And again,
3 recognizing this issue, the SAS 114 issue, will be
4 reviewed by the ad hoc committee because it will
5 address the level of involvement of the board with the
6 audit.

7 We did plan a year ago to go through this. So
8 if you can complete your summary of this, go through
9 your one-page outline, we'd be very grateful.

10 MS. DAVIS: All right. So Roman numeral I
11 just talks about the role of communication. And again,
12 it indicates that there's supposed to be communication
13 early on in the process of the audit, and that timely
14 observations are reported to you all, and that there's
15 an overview of the plan, scope, and timing of the audit
16 that's communicated.

17 This is generally done in the form of an
18 engagement letter or some similar vehicle so that you
19 know exactly what the scope of the audit is that's been
20 planned, and have -- can weigh in on it at that point.

21 We discuss significant findings from the
22 audit, as indicated there. And we establish a

1 communication process at the outset on terms of who may
2 be the point person for the communication point for the
3 auditors, who the auditors will meet with. Will they
4 meet with an audit-type committee? Will they meet with
5 the full board? What is the nature of the
6 communication relationship?

7 And we are then -- our responsibility as
8 auditors on the back end is to make an assessment on
9 terms of the adequacy of the communication that has
10 taken place in case there's some difficulties along the
11 way. And all communications are to be documented.

12 CHAIRMAN McKAY: Thank you. Any questions?

13 (No response.)

14 CHAIRMAN McKAY: Could you just briefly
15 describe the remaining pages? Just tell us what's
16 there, and then we can read this at our leisure.

17 MS. DAVIS: Right. I will. The next page is
18 a very brief summary of eight new auditing standards
19 that are known are the risk assessment standards. In
20 most cases, they are older standards that now have been
21 revised and updated to include more rigorous procedures
22 to be performed.

1 But it now requires that an IPA perform an
2 audit on a risk-based approach. In the past, IPAs have
3 frequently established a level of materiality, and the
4 audit work and the audit procedures performed is in
5 light of that materiality or that dollar threshold.
6 Items and transactions that fall below that threshold
7 are considered not relevant for the purpose of issuing
8 an opinion on the financial statements taken as a
9 whole.

10 What this does now is it requires that a
11 risk-based approach be followed so that risk, in
12 conjunction with materiality, have to be brought
13 together; that at the inception of the audit, the
14 auditor will have a brainstorming session to identify
15 potential risks within the organization; and then
16 throughout the course of the audit, that risk
17 assessment procedures are designed to address those
18 potential risks.

19 And at the back end, that there's a linkage
20 shown between what was performed and the risks
21 identified at the outset, and then a conclusion is
22 drawn based on that.

1 And so this concept of risk, risk, risk,
2 you're going to hear a lot of that going forward. You
3 see it laced through the GAO report. It's because this
4 is -- and the emphasis being on assessed risk. WHAT IS
5 the risk? And then your response is in relationship to
6 the risk assessed. And that's where these are coming
7 from.

8 So IPAs generally across the board have, based
9 on what is required of us and all the additional
10 documentation to show that we did in fact comply, will
11 add about 20 percent in terms of the hours to the audit
12 in order to comply. So this is part of what different
13 accounting firms have had to assess as they've figured
14 out how best to implement these in a cost-effective
15 way.

16 So I've included these just simply to give you
17 a brief summary of what those risk assessment standards
18 include. After that, I've included on a page there
19 risk assessment terminology. These are buzzwords that
20 you will now hear. For those of you that are involved
21 in oversight of the audit function, whether the
22 external auditors or the IG function, you will hear

1 these terms used more and more.

2 As I indicated before, like last year with the
3 implementation of SAS 112, the terminology "reportable
4 condition" was phased out and reporting condition has
5 now been called "significant deficiency," to align the
6 vocabulary more to what is now being required under the
7 PCAOB. So I just wanted to put these in here to make
8 you familiar with some of those terms because you will
9 hear them.

10 The last page here I attached primarily for
11 the benefit of management. I knew there would be those
12 of you from management present. I have been asked by
13 management, in light of these new auditing standards,
14 what is the expectation that we will have as auditors
15 for what management is to be doing?

16 And I think I want to address this just
17 briefly, to the extent that just as the accelerated
18 filers and the federal government agencies now on the
19 management side have had to step up their assessment
20 of -- their documentation, assessment, and testing of
21 internal controls, that these five components of
22 internal controls have existed for many years.

1 Management's implementation of these have been
2 sometimes formal, sometimes informal. But what is now
3 required is that management take responsibility to
4 ensure that all components of internal control are in
5 place and that they're operating effectively.

6 As auditors, we will come in and ask, what is
7 your risk assessment process? Show us how it works,
8 and how, when you design an internal control to address
9 a certain risk, what are you doing on the back end to
10 monitor to ensure that its implementation has been
11 effective?

12 CHAIRMAN McKAY: And during our meeting
13 yesterday, you also said not only is it being done, but
14 also it's documented that it's being done, which is
15 very important.

16 MS. DAVIS: It's documented that it's being
17 done.

18 CHAIRMAN McKAY: Doing it isn't enough.
19 Documenting that it was done is quite important.

20 MS. DAVIS: Well, and again, as I indicated
21 with the GAO's report on governance sort of my
22 perspective in reading some of the things that they

1 included. For example, the topic of the financial
2 reporting model that LSC follows under GASB 34, when
3 that standard was issued, during that year there was a
4 discussion with the board, the IG, management, a very
5 rigorous discussion that went on, as you all are in
6 your discussion about an audit committee and a finance
7 committee.

8 Very thoroughly discussed and vetted. It was
9 a concurrent decision on the part of everyone involved
10 that this would be an appropriate way to go forward in
11 terms of that reporting model. But when GAO came in
12 and asked about that, as auditors we had a
13 documentation of the analysis, but management did not.

14 So they included that in the report. And it's
15 not because management didn't do it. They certainly
16 were a part of that process. But there wasn't anything
17 there to show that they had. So again, as you
18 participate in this process, as the board participates
19 in exercising their responsibilities under SAS 114, you
20 document those efforts.

21 CHAIRMAN McKAY: Thank you. Are there any
22 more questions on this subject?

1 (No response.)

2 CHAIRMAN MCKAY: Dutch, do you have anything
3 else to add on this?

4 MR. MERRYMAN: I do not, sir.

5 MS. DAVIS: May I have one more topic?

6 CHAIRMAN MCKAY: Please.

7 MS. DAVIS: Since I think you're going to go
8 on here. I wanted to bring to your attention that also
9 for fiscal year 2008, that there is a new Form 990, the
10 information return that is the tax return that
11 not-for-profits complete and submit to the IRS every
12 year.

13 It has not been updated in many, many years.
14 It is out in draft right now, but will be applicable to
15 you all in fiscal year 2008. We plan to meet with
16 management to discuss the changes in the form, but one
17 of the things that it does specifically do is that
18 there are a number of questions regarding the
19 governance of the not-for-profit that are required to
20 be asked and answered, additional disclosures, and
21 policies.

22 So we will talk with management early on in

1 the year. There will be some additional schedules and
2 information that will need to be accumulated through
3 the year. I've provided a copy to Mr. McKay and to
4 make you all aware.

5 I also recommended that -- I don't believe up
6 to this point that members of the board have reviewed
7 the 990 return before it's submitted, but I recommend
8 that that would be an important part of your oversight
9 efforts as well.

10 All 501(c)(3) not-for-profits organizations,
11 your 990s are up on the web. They're posted on
12 Guidestar, largely targeted toward charitable
13 organizations so that donors can see what's going on
14 with the money. But LSC also has their 990, and it is
15 a public document.

16 CHAIRMAN MCKAY: Thank you.

17 MS. SINGLETON: So do most of our grantees, in
18 case you're interested, if you want to look them up.

19 MS. DAVIS: That's true.

20 CHAIRMAN MCKAY: Any other questions or
21 comments?

22 (No response.)

1 CHAIRMAN McKAY: Thank you both very much.

2 Item No. 6 on the agenda is fiscal year 2008
3 appropriations. Mr. Constance.

4 MR. CONSTANCE: Good morning. For the record,
5 I am John Constance, director of government relations
6 and public affairs for the Legal Services Corporation.
7 It's my pleasure to be with you this morning.

8 On Wednesday, December 26, 2007, President
9 Bush signed H.R. 2764, the Omnibus Appropriations Act,
10 which provides \$350.5 million for the Legal Services
11 Corporation for FY 2008. While this figure represents
12 a slight increase over LSC's FY 2007 budget of \$348.6
13 million, it is a significant decrease from what the
14 House and Senate recommended for LSC earlier last year.
15 The House had approved \$377 million for LSC in June,
16 and the Senate approved \$390 million in October.

17 This unexpected outcome was part of the
18 \$22 billion in discretionary spending that
19 congressional appropriators had pared down to avoid a
20 veto by President Bush, who had threatened to reject
21 any bill that exceeded the spending limits in his
22 budget. The \$22 billion had been moved by the Congress

1 from the President's proposed defense budget and
2 distributed to discretionary domestic spending earlier
3 in the budget process.

4 Given the fact that a disproportionate share
5 of the transfer had come to the Commerce, Justice,
6 Science, and Related Agencies Subcommittee, CJS, when
7 the allocations were readjusted going into the last
8 weekend of negotiations, CJS took a disproportionately
9 large share of that reduction.

10 However, LSC fared better than most other
11 non-Cabinet agencies in the bill. Only the National
12 Aeronautics and Space Administration and the
13 International Trade Commission received greater
14 increases than LSC over 2007 levels, and others
15 remained at flat funding or were cut in the final
16 budget.

17 The breakdown you'll find on on page 185 of
18 your board books. That's the breakdown of the \$350
19 million appropriation. And you'll see by that chart
20 that it includes \$332.4 million for basic field grants,
21 \$2.1 million for technology initiatives, \$500,000 for
22 loan repayment assistance, and \$12.5 million for

1 management and administration, and \$3 million for the
2 Office of the Inspector General.

3 Overall, the funding represents 1/2 of
4 1 percent increase over FY 2007. LSC, as you know,
5 operated at FY 2007 levels under a series of continuing
6 resolutions from October 1st until December 26th of
7 last year.

8 We were, I think it would be an understatement
9 to say, greatly disappointed that we did not receive
10 the budget increase that we had expected all year. As
11 you know, over 95 percent of that increase would have
12 gone directly to 137 programs, providing crucial civil
13 legal assistance to low income Americans facing
14 domestic violence, eviction, predatory lenders, and
15 other serious legal problems.

16 In the language of the Hill, however, I am
17 happy to be able to report and to assure the board that
18 the cuts were without prejudice, meaning that LSC was
19 not singled out in the final negotiations and the final
20 action.

21 The challenge, as you've heard this morning, I
22 think, was and remains to be an understanding that

1 while additional basic field dollars are a necessity to
2 close the justice gap in America, oversight by LSC is
3 not free and will require continued funding to keep up
4 with the growth of the program increases, the changes
5 in the law, and the expectations of the Congress.

6 Other things in that same appropriations bill
7 included locality pay and inclusion of H-2B forestry
8 workers that I'll just briefly touch on.

9 With regard to locality pay, H.R. 2764
10 contained our requested language to approve the
11 continuation of our locality pay system for FY 2008
12 at a rate not to exceed the federal program level.
13 Throughout the appropriations cycle, this issue was
14 fully discussed with the appropriators, majority and
15 minority in both the House and the Senate, as well as
16 our authorizing committees, and the continuation of
17 this program met with no opposition in the process, as
18 evidenced by the final bill language.

19 As to the H-2B forestry workers, Senator
20 Bingaman of New Mexico sponsored an amendment to
21 authorize LSC-funded programs to provide limited
22 representation to temporary forestry workers. The

1 provision allows the programs to represent non-citizens
2 legally employed in the U.S. as temporary forestry
3 workers under the H-2B visa problem.

4 We had been asked throughout the process, I
5 believe, earlier with the immigration bill as to the
6 impact of this on our programs, and the analysis had
7 been that while there was a clear need for civil legal
8 assistance among this community, there would not be a
9 large impact on our programs themselves due to the
10 relatively small population represented.

11 That is the conclusion of my report,
12 Mr. Chairman. Happy to answer any questions.

13 CHAIRMAN McKAY: Thank you. Of course, we
14 received your e-mail communications and are generally
15 aware of this issue. The information you gave us was
16 very helpful.

17 Are there any questions or concerns from the
18 committee?

19 MR. MEITES: I have a question, a very simple
20 question. Remind us of the schedule for the next
21 budget cycle?

22 MR. CONSTANCE: We are in the process of

1 putting together the actual document that will go
2 forward to the Congress. It reflects the actions of
3 the board in approving the finance committee's
4 recommendations from their September meeting.

5 It represents a request that is going to be
6 pre-briefed to the Hill beginning next week. And the
7 final document, our deadline is to have that document
8 go before the Congress by January 31st.

9 Our hope is that given the fact that we're not
10 constrained by the exact same budget cycle as the
11 federal government, that we can get our document up
12 there before the President's budget arrives and
13 therefore be in a position to speak to these folks
14 before the onslaught.

15 So that is where we are. As mentioned
16 earlier, Tom, we had an appropriations hearing last
17 year at the end of March. The expectation would be
18 that it would be somewhat within that same time frame,
19 and on from there, the rest of the cycle being in the
20 Congress's hands. And as you know, that's an
21 interesting cycle from year to year. So we await its
22 conclusion.

1 CHAIRMAN McKAY: Any other questions?

2 (No response.)

3 CHAIRMAN McKAY: Thank you very much.

4 MR. CONSTANCE: Mr. Chairman, the last thing I
5 would like to say, I think we would be remiss if we did
6 not recognize NLADA, ABA, and our other partners and
7 advocates who worked tirelessly through the process
8 this year.

9 And I thank you, Mr. Chairman and the
10 committee, for your many kindnesses. The Congress was
11 helpful in setting the bar low enough that I can say
12 without fear of contradiction we will do better next
13 year.

14 CHAIRMAN McKAY: Well, thank you. And thank
15 you very much for your good work as well, John.

16 Next item on the agenda is consider and act on
17 locality pay. Are we going to hear from anyone, or do
18 you want me to just dive into it? Charles?

19 MR. JEFFRESS: Thank you, Mr. Chairman.
20 Charles Jeffress, chief administrative officer.

21 There is a resolution in your notebook on
22 locality pay. There is not a separate staff report.

1 You just heard John Constance's report on what we're
2 saying with respect to that. I'll be happy to answer
3 any questions if you have them.

4 CHAIRMAN McKAY: Invite your attention to page
5 197 in the board book, tab entitled, "Resolution
6 2008-003." It's something I've carefully gone over,
7 talked to staff. Invite your attention to one
8 potential issue, which after reflection on my part is
9 not one but I think it's important that we put it on
10 the record.

11 The proposed resolution cites the relevant
12 legislative language and the opening clause reads,
13 "That the Legal Services Corporation may continue to
14 provide locality pay to officers and employees" at a
15 particular rate.

16 And the question I would raise is, obviously
17 prospectively we're okay. But does this validate and
18 allow those officers who withheld payment last year to
19 receive payment last year? And I've looked at the
20 statute, and obviously we can't turn to Vic because he
21 has a conflict on this.

22 But the statute says, "may continue to provide

1 locality pay." And as we note, Congress isn't going to
2 put language in there unless they have a reason for it
3 because if they were just talking prospectively, it
4 would read, "may provide locality pay."

5 So when I look at this, it's clear to me that
6 Congress is authorizing us to go back and pay this
7 prudent decision that we made, and certainly the
8 sacrifice made by those who were withheld a certain
9 amount of their pay. But now that Congress has passed
10 the statute, it seems to me we can authorize the
11 repayment or payment of funds that was withheld last
12 year.

13 And so if there was any question, I'd
14 recommend we send it to outside counsel for advice. I
15 don't believe it's necessary, but I thought it was
16 important that we put this out on the record.

17 Are there any other comments or concerns?

18 M O T I O N

19 MR. GARTEN: Move adoption of the resolution.

20 CHAIRMAN McKAY: Do I hear a second?

21 MS. BeVIER: Second.

22 CHAIRMAN McKAY: All those in favor, say aye.

1 (A chorus of ayes.)

2 CHAIRMAN McKAY: Opposed?

3 (No response.)

4 CHAIRMAN McKAY: The resolution passes. Thank
5 you very much.

6 Next item is consider and act on adoption of
7 consolidated operating budget for fiscal year 2008.
8 Mr. Richardson and Mr. Jeffress.

9 MR. RICHARDSON: Good morning. For the
10 record, I am David Richardson, the treasurer of the
11 Corporation. I will be referring to page 186 in your
12 board book for this agenda item.

13 When we last met in October, we passed a
14 temporary operating budget based on the lower of the
15 House or Senate-passed bills. And as you've just
16 heard, we received less than that. The budget that was
17 passed was \$382 million, and we need to reduce our
18 budget to \$359 million.

19 The memorandum goes through the steps that we
20 have done, that we have completed, to get the budget to
21 this process. We had to reduce the basic field
22 program, and as you'll see at the bottom of page 186,

1 the lesser of the House or Senate was \$355 million. We
2 did receive \$332.4 million. So you see the reduction
3 there is \$22.7 million. Each of those lines that are
4 shown there shows the increase or decrease that we had
5 to go through to make this budget work.

6 On page 87, there was additional adjustments
7 that needed to be made because of carryover. And I
8 have detailed that in the table there also. The
9 largest of the items is the \$450,000, the money that
10 Ms. Davis mentioned that we received in late October,
11 that there was an agreement put in place in July and we
12 were not aware of the agreement in my particular
13 office. And the agreement came later. So we had to go
14 back and accrue that amount to get it into last year's
15 statements, and we did that.

16 There is another reduction to the budget that
17 came about because of the U.S. Court of Veterans
18 Appeals. Last year they received \$2.16 million. And
19 this year the grantee only asked for \$1.21 million, so
20 that's the reason for the reduction there. It's
21 nothing that we did. It was the grantee decided that
22 they didn't need as much money this year as they

1 received in the prior year.

2 The steps that we have gone through I have
3 delineated on page 3. I don't propose to go through
4 those. If you have any particular questions as to the
5 steps that we went through, I would be glad to comment
6 on those. But I think it's pretty self-explanatory.

7 CHAIRMAN McKAY: The only question I have
8 about that list on page 188 is the reduction of
9 \$100,000 for Office of Legal Affairs. That's the third
10 item down. And I'm wondering if it would be
11 appropriate to hear from you or from Vic as to the
12 impact of that because that's a lot of money. And
13 realizing the litigation that we're facing, I'm just
14 wondering what the impact is. Could someone comment,
15 Charles or Vic?

16 MR. JEFFRESS: I will comment on that, and Vic
17 may want to comment on that as well. This an estimate.
18 We had allocated \$400,000 for legal fees for outside
19 consultants. We don't have at this point a good sense
20 of how much we will face.

21 We have also -- I'll let Vic talk about
22 this -- but there's a potential recovery of some of the

1 costs we paid last year from the insurance company. So
2 there's a potential that more money will come in for
3 this line item.

4 But at the moment, with a \$400,000 budget
5 there, we felt like cutting \$100,000 was acceptable.
6 Should there be legal fees in excess of that and are
7 not recovered, we will have to come back to you later
8 in the year to transfer money from some other place
9 back to --

10 CHAIRMAN McKAY: Very good. Thank you.

11 Any other questions or concerns?

12 (No response.)

13 CHAIRMAN McKAY: Anything further from you,
14 David?

15 MR. RICHARDSON: No, sir. There's not.

16 CHAIRMAN McKAY: Charles?

17 MR. JEFFRESS: Just one comment. I want to
18 commend Board Member Singleton, who at the last meeting
19 suggested we should have budgeted at the flat rate
20 after all. She was exactly right, and lesson learned.

21 CHAIRMAN McKAY: Let's make sure that's in the
22 minutes.

1 Invite your attention to page 192, Resolution
2 2008-002. And for those of us who've had a chance to
3 look at this, is it fair to say that this resolution
4 incorporates the recommendations or what's contained in
5 the memorandum you've just gone through, David?

6 MR. RICHARDSON: That is correct, sir.

7 CHAIRMAN McKAY: Do I hear a motion with
8 regard to this resolution?

9 M O T I O N

10 MR. GARTEN: So moved.

11 CHAIRMAN McKAY: Second?

12 MS. BeVIER: Second.

13 CHAIRMAN McKAY: Discussion?

14 MR. FUENTES: Just to clarify that again these
15 resolutions, which we did not mention at the last
16 resolution which we just passed, are motions of this
17 committee to recommend to the board, as opposed to the
18 adoption of the resolution.

19 CHAIRMAN McKAY: Correct. Thank you for
20 clarifying that. Any more discussion?

21 (No response.)

22 CHAIRMAN McKAY: All those in favor of

1 recommending this resolution to the full board say aye.

2 (A chorus of ayes.)

3 CHAIRMAN McKAY: Opposed?

4 (No response.)

5 CHAIRMAN McKAY: The motion passes.

6 Item No. 9 is the presentation of financial
7 reports for the first three months of this fiscal year.
8 Gentlemen.

9 MR. RICHARDSON: You received an e-mail last
10 week in regards to the financial statements for
11 December. I had labeled them as 196(a) through 196(h).
12 I hope you've had an opportunity to review those.

13 I have prepared those based on the budget that
14 you just passed. I thought it would be a more
15 meaningful report to show it with this particular
16 budget, knowing that we would have to reduce it.

17 The items within the budget are clearly well
18 within our spending guidelines of the new budget.
19 Within the basic field, we did provide grants on an
20 annual basis based on the 2007 appropriations. We will
21 go back in February and make the additional allocation
22 of money that the increase that the basic field is to

1 receive. So far we've spent \$327 million of the \$335
2 million budget that you've just approved.

3 Within management and administration, you see
4 that even though we had a \$500,000 greater budget to
5 spend based on the temporary budget, reducing it
6 \$500,000 we still have a variance. We were under
7 budget \$530,000. So we're still very prudently
8 watching our spending and planning accordingly.

9 The loan repayment, you'll see at this
10 particular point we have \$1.295 million. In the next
11 week we will be approving the cancellation of \$349,000
12 worth of loan repayment assistance awards that pertain
13 to 2007, so those will be showing up as an expense in
14 your next reporting period.

15 The IG, as you see, is well within budget.
16 There's an amount under budget of \$343,000.

17 When you look at page 196(e), skipping (d) at
18 this point -- let me go back to (d) and just say that
19 there is no budget that is over -- no office budget
20 that is over. So we're well within budget.

21 There is one area that is revealed on 196(e)
22 that is overspent, and that is the temporary operating

1 budget line. And that was because we were anticipating
2 an employee coming in, and that employee has started in
3 November.

4 We had a temporary employee in the Office of
5 Legal Affairs from October, November, and December
6 during the transition, and then during the remainder of
7 the year that temporary employee is no longer required
8 since we now have the regular employee in the office.
9 So it's sort of up-front expensed money that we do not
10 anticipate the remainder of the year.

11 CHAIRMAN McKAY: Thank you. Any No, sir or
12 comments? Or, excuse me, Charles. Comments from you,
13 please?

14 MR. JEFFRESS: Nothing to add. Thanks.

15 CHAIRMAN McKAY: Thank you. Any questions or
16 comments from the committee or other members of the
17 board?

18 MS. PHILLIPS: Mike, this is Bernice Phillips.
19 I'm not a member of the committee, but I have a
20 question.

21 CHAIRMAN McKAY: Please.

22 MS. PHILLIPS: On page 195, compensation and

1 benefits, \$814,000. I just wanted to ask David: Who
2 was in that line item? What does that consist of?

3 MR. RICHARDSON: I'm not sure exactly which
4 line you said.

5 MS. PHILLIPS: The executive -- on page 195,
6 executive office, compensation and benefits. How many
7 employees are in that line item?

8 MR. RICHARDSON: If I'm not mistaken, there's
9 six. It would be the president, the chief
10 administrative officer, the vice president of programs,
11 and two executive assistants. So it's actually five.

12 MS. PHILLIPS: Thank you.

13 CHAIRMAN MCKAY: Any other questions or
14 comments?

15 (No response.)

16 CHAIRMAN MCKAY: Thank you very much.

17 Next item is item No. 10 on the agenda,
18 consider and act on recommendations to the board to
19 establish an audit committee or to assign audit
20 committee functions to the finance committee. And this
21 is an issue that we have been discussing for the last
22 couple of meetings. I've asked Ms. Davis to step

1 forward, Mr. Jeffress, Mr. Fortuno, and Mr. Merryman.

2 I would invite the committee's attention to
3 the fact that this is another issue that of course is
4 in the first GAO report. It might be something we'd
5 want to add to the list for the ad hoc committee,
6 assuming it's created. But certainly it's something we
7 should discuss today.

8 I'm not entirely sure we want to reach a
9 decision today, for a series of reasons. One, the
10 first one, we have this ad hoc committee that will be
11 addressing these issues. Secondly, staff has been
12 doing some very good work. We received some materials,
13 some as recently as the last day or so, that probably,
14 in light of its importance, would warrant some
15 additional thought.

16 But particularly with Ms. Davis here, I did
17 ask that she participate in this part of the discussion
18 because she could give us some valued insight as well
19 as the other members at the table. So please identify
20 yourselves for the record, and perhaps you can begin
21 with some brief opening remarks, each of you.

22 MR. MERRYMAN: That's so I don't have to

1 repeat everything everybody else says. My name is
2 Ronald Merryman, acting inspector general. I think
3 this is a very important subject for the committee to
4 be taking on, the board to be taking on, in helping to
5 establish governance of the organization, the
6 Corporation, and also provide some clarity in roles and
7 responsibility that does pertain to the audit. And I
8 look forward to working through this process.

9 CHAIRMAN MCKAY: Thank you.

10 MR. FORTUNO: I'm Victor Fortuno, general
11 counsel. and I think that everyone appreciates the
12 importance of the issue at hand. I think that you've
13 been provided some materials so that you know what
14 other similarly situated entities, such as the
15 Corporation for Public Broadcasting, are doing, what
16 approach they've taken.

17 And you have a couple of different approaches
18 that you can discuss. You've got the drafts, and
19 hopefully we can make some progress this afternoon
20 or -- yes, just about afternoon.

21 CHAIRMAN MCKAY: Thank you.

22 MS. DAVIS: I'm Nancy Davis, a partner with

1 WithumSmith+Brown. And I've been asked to participate
2 in this discussion. And I've been apprised of some of
3 the information that you all have put together on the
4 topic. But I'm interesting in hearing what you
5 all -- the concerns and things that you all have to
6 bring up.

7 CHAIRMAN MCKAY: Thank you.

8 MR. JEFFRESS: Charles Jeffress, chief
9 administrative officer. Just to mention some of the
10 materials that have been given to you, you have drafts
11 of what a charter for an audit committee, what
12 stand-alone audit committee might look like, provided
13 by Victor Fortuno. And you have a draft of a charter
14 of what an audit plus finance committee would look
15 like, in case those are two of the options that you
16 want to think about and consider.

17 The materials that were sent reflecting the
18 other -- there's five other organizations to give you a
19 sample -- some do it with audit plus finance, like the
20 Corporation for Public Broadcasting, some have separate
21 audit committees, and some have audit and ethics
22 committees. Considering that we may have a code of

1 conduct, it might be useful for you to think -- as
2 you're thinking about the audit committee, should that
3 include ethics responsibilities as well.

4 And again, by way of background, LSC at one
5 time had an audit and finance committee, one committee
6 that performed both functions. With the appointment of
7 the inspector general and the inspector general taking
8 primary responsibility for the audit in recent years,
9 that audit was dropped from the board committee and it
10 became just the finance committee.

11 But there are a variety of ways of doing this.
12 I don't know that there's any one way that's right or
13 wrong. It obviously benefits from having a separate
14 group look at the audit from the group that actually
15 spends the money. There are also, though, with a small
16 organization, small number of directors, some benefits
17 to having fewer committees and performing that
18 function.

19 CHAIRMAN McKAY: Thank you. Vic, I'm
20 wondering if you could begin by just simply, very
21 briefly, identifying the key topics or areas of
22 responsibility for the finance committee as it current

1 exists, and what are the key items of responsibility
2 for an audit committee, whether it's separate and
3 standing alone or it be part of the finance committee.

4 MR. FORTUNO: I think, very simply put, and
5 with Nancy Davis here and with the acting IG here, I
6 think they can provide a more comprehensive view of it.

7 But it seems to me that the finance committee
8 is responsible largely for budgeting and expenditure
9 matters -- how much money we have, how we're going to
10 use, it how it's going to be distributed, and approving
11 specific expenditures. And that happens in the
12 way -- that is, the approval of specific expenditures
13 can be in the way of reallocations and the approval
14 process provided for in the budget guidelines.

15 I think that the audit committee would have
16 not a budgeting function but an oversight
17 function -- working with systems to ensure that the
18 information is correctly recorded, that the information
19 is correctly presented, that the requisite cooperation
20 exists.

21 And it can actually be more than that. But in
22 terms of right down to the core what they get to, it

1 seems to me that that's the distinction. One does the
2 budgeting. The other does the oversight to ensure the
3 accuracy of the information.

4 CHAIRMAN McKAY: And then with regard to that
5 audit committee, you would agree that would also
6 include the responsibility of supervising the annual
7 audit or overseeing the annual audit?

8 MR. FORTUNO: Yes. Typically, that is one of
9 the principal functions, if not the principal function,
10 of the audit committee. LSC has developed a practice
11 over the years where the selection of an auditor has
12 fallen on the IG, and IG has handled the supervision of
13 the auditor.

14 That's not required anywhere, but it's a
15 practice that's developed at LSC. And one of the
16 decisions you're going to have to make is whether you
17 go with a freestanding audit committee, or a combined
18 audit and finance, or some other, some
19 variation -- audit and governance, audit and ethics;
20 whether you want the committee to be responsible for
21 that, or whether you want the inspector general to
22 continue to perform that function, or you want some

1 hybrid, for example, the committee in consultation with
2 the inspector general.

3 CHAIRMAN McKAY: Do the rest of you agree with
4 the delineation of duties as described by Vic?

5 (All indicate yes)

6 CHAIRMAN McKAY: That being the case, I guess
7 the real issue that we ought to be addressing right now
8 is -- and recognizing we need some kind of audit
9 function; I think that's a given. Is there any
10 question about that? We clearly need an audit
11 committee function.

12 The question, it seems to me, for us to
13 discuss now and I'd propose is whether or not -- and
14 not for final decision today, I would propose -- but
15 the pros and cons of having a separate standalone audit
16 committee, or audit and ethics committee, or have those
17 functions subsumed in part of this committee, as the
18 finance committee.

19 And I'm wondering if we can hear from all four
20 of you on that subject. Let's start with Nancy since I
21 posed the question to you, and you've had at least
22 24 hours to reflect upon it.

1 MS. DAVIS: There is no legal requirement that
2 a not-for-profit have a separate standalone audit
3 committee except in the state of California, as I
4 understand it. Charitable organizations that have
5 revenues in excess of \$2 million are required to have a
6 separate audit committee.

7 It has not been implemented. The other states
8 have not followed suit, for the most part, because when
9 you talk about -- use the term not-for-profit, you talk
10 about a full range of entities, from the little bitty
11 not-for-profits to the very large hospitals and
12 universities.

13 So clearly you can't do a one size fits all.
14 And clearly there is a cost benefit, when you have
15 small organizations, as to their ability to do both.
16 While you all consider yourself a small organization,
17 in the not-for-profit world, based on your revenues,
18 you would be considered quite large.

19 So I believe that in keeping with that, that
20 it would be appropriate to have a separate audit
21 committee from the finance committee, largely because I
22 believe that the tasks and the scope of

1 responsibilities of those two committees would be such
2 that it would require the kind of resources that would
3 be necessary to do so.

4 And clearly now, in light of some of the
5 responses to the GAO report and whatnot, that there
6 will be some issues going forward that will need to be
7 addressed on an ongoing basis that will take that level
8 of effort. And so I believe that that would be best
9 practice.

10 CHAIRMAN MCKAY: Thank you. I'm sorry.

11 Excuse me. Herb?

12 MR. GARTEN: Can I ask something?

13 CHAIRMAN MCKAY: Absolutely.

14 MR. GARTEN: In a prior appearance before us,
15 you alerted us to the requirements of Sarbanes-Oxley.
16 And how does that fit in? If I recall correctly, there
17 was a requirement for an audit committee.

18 MS. DAVIS: That's correct.

19 MR. GARTEN: And the limited experience I have
20 had with a much smaller entity was that it would be
21 advisable to have a separate committee. Is that the
22 basis in part for the recommendation you've made?

1 MS. DAVIS: Yes. And just based on the
2 perspective of the federal government in these matters,
3 I think that they would be -- I think that the
4 recommendation on the part of GAO, although they were
5 addressing the fact that the scope of the finance
6 committee did not address audit committee functions, I
7 think that that was what was in part in keeping with
8 what they were recommending.

9 MR. GARTEN: Thank you.

10 MR. FUENTES: Nancy, I'm somewhat familiar
11 with the California model of separateness. What would
12 be normal practice in terms of the composition of these
13 two committees? Could members of the finance committee
14 compose the audit committee, or in part compose the
15 audit committee, or vice versa?

16 MS. DAVIS: Yes. My understanding is that you
17 can have that overlap, that what is significant is that
18 the members of the audit committee must be independent
19 to the organization; that the chair of the audit
20 committee would not also sit on the finance committee;
21 and ideally, that the members -- there would not be
22 more than 50 percent -- the membership of the audit

1 committee would not have more than 50 percent
2 membership from the finance committee.

3 It's also that it is necessary obviously for a
4 certain level of expertise to exist for both of those
5 committees. But it is well within the board's
6 prerogative in those situations to have individuals
7 outside the committee that would serve in that capacity
8 in order to bring some of that to the table.

9 MR. FUENTES: Do you mean outside the board?

10 MS. DAVIS: Yes. That there could be other
11 additional members to that committee. And I don't know
12 whether within what you all have here at LSC, that that
13 would work. But I do know that that does operate in
14 other not-for-profits.

15 MR. FUENTES: Thank you.

16 CHAIRMAN MCKAY: Let's hear from the rest of
17 you, please, on this issue.

18 MR. JEFFRESS: Charles Jeffress. Just one
19 observation I would have. I respect the philosophic
20 reason why the committees need to be separate. At LSC,
21 most board members attend most every committee meeting.
22 And by statute, we can't add additional directors. You

1 could add consultants or someone to meet with you. You
2 could not add another director.

3 So I'm not sure of the -- while on paper a
4 separate committee might look good, in practice it's
5 really going to be the same people attending the same
6 meetings and means the same thing, for the most part.

7 CHAIRMAN MCKAY: Isn't it possible we've
8 reached the point -- I mean, look at the schedule we've
9 had this weekend. Have we reached the point where
10 committees could be meeting -- would have to be meeting
11 simultaneously and then truly reporting back to the
12 board?

13 MR. JEFFRESS: The difficulties of that is
14 within only ten members, and we've functioned with
15 fewer than that when there have been vacancies in the
16 past, if you're going to have a committee, it's going
17 to involve perhaps four or five of the directors.

18 So it's very difficult to get committees
19 meeting simultaneously when people serve on more than
20 one committee. I'm not going to say it can't be done,
21 but you'd have much smaller committees and probably
22 much less knowledge amongst board members of the

1 business of the Corporation.

2 CHAIRMAN MCKAY: Perhaps. That's a good
3 point.

4 Dutch?

5 MR. MERRYMAN: From my point of view, I think
6 it would be preferable to have a separate committee.
7 It helps to delineate the role and what hat is being
8 worn at the time comments are made without question.
9 Am I talking as a member of an audit committee who has
10 oversight responsibility and commitments for the
11 finances, as opposed to the finance committee, who is
12 putting information together to get the budget?

13 We've been talking mainly about financial
14 auditing mainly in regard to the financial statement
15 audit. But the audit committee would also, in my mind,
16 function for any type of audit, whether it be GAO or
17 OIG audit. And that would add to the burden of the
18 committee also.

19 So I think it would be, in my mind, preferable
20 to have a separate committee.

21 CHAIRMAN MCKAY: Thank you. Vic?

22 MR. FORTUNO: I would agree. In my own

1 judgment, I think that I certainly have a preference
2 for the separate committee, for a freestanding audit
3 committee or audit and something else, as opposed to
4 combination audit and finance.

5 I think it does help to clarify the roles. I
6 think they are different roles, at the very core. I
7 think that it presents a challenge. I think it's a
8 limited group. The organization right now is headed by
9 ten directors. But we've done that in the past. We've
10 operated with concurrent committee meetings.

11 I think that it's a matter of, if you want to
12 do that, doing it, committing to it, I think it
13 presents a challenge in terms of scheduling, ensuring
14 that you schedule things so that all members of that
15 committee are available and not tied up on another
16 committee that they serve on.

17 But I think that can be accomplished. And I
18 think that the better outcome is two committees.

19 CHAIRMAN McKAY: Let's open this up for some
20 discussion. And what I would encourage us to do is
21 spend a couple of minutes sharing some of our initial
22 thoughts. And then assuming that the board approves

1 the adoption of this or creation of this ad hoc
2 committee, that we ask the ad hoc committee to look at
3 this as part of the overall response to the GAO
4 reports.

5 But Tom, you were going to say something?

6 MR. FUENTES: I was going to ask Nancy again:
7 Have you had time to think through -- the line officer
8 function relationship of the finance committee to
9 management is the treasurer. Would you assume that the
10 line officer dealing with the audit committee would be
11 the inspector general?

12 MS. DAVIS: I would assume that here.

13 MS. BeVIER: I think that I endorse the idea
14 of a separate audit committee. But I also am very
15 worried about it is an additional layer of work for the
16 board -- not that we're averse to that. But I just
17 don't know how we can conduct these meetings in two
18 days.

19 And I would urge the ad hoc committee, should
20 one be appointed, to think carefully about a
21 recommendation that two separate personnel groups, two
22 separate groups of directors with no overlap so that

1 they could meet simultaneously. That would keep the
2 functions separate and make clear the assignment of
3 responsibility, and it would possibly achieve some
4 efficiency in terms of the use of the board's time
5 during our meetings.

6 CHAIRMAN MCKAY: Thank you. Herb?

7 MR. GARTEN: Nancy, when you listed the
8 requirements of membership on the audit committee, I
9 wondered whether that precluded having the finance
10 committee and the audit committee being one and the
11 same, when you talked about independence from each
12 other.

13 So how in practice, if you did keep it within
14 the one committee, could the audit group function?

15 MS. DAVIS: That they would be separate and
16 distinct from the --

17 MR. GARTEN: Yes. The members of the
18 committee?

19 MS. DAVIS: I'm not sure I understand exactly.

20 MR. GARTEN: If I'm a member of the finance
21 committee, how can I as a continuing member of the
22 finance committee, based upon what you said the

1 requirements were, be also part of that same group as a
2 member of an audit subcommittee? Let's put it that
3 way.

4 MS. DAVIS: Oh, I see what you're saying.

5 MR. GARTEN: I don't see where it's possible
6 for the one committee to do both functions based upon
7 what you set forth as the requirements.

8 MS. DAVIS: I think that the context there in
9 terms of the independence is in terms of the
10 relationship to the organization. In other words, do
11 you have other activity that you deal with the
12 organization in another level? I wasn't necessarily
13 referring to the finance committee function itself.

14 MR. JEFFRESS: Herb, I can also respond to
15 that. I think in many cases in private corporations
16 there are officers of the corporation who are also
17 directors. I think that's in the independence mode.
18 They didn't want an officer who is also a director to
19 be chair of an audit committee.

20 CHAIRMAN McKAY: Tom?

21 MR. FUENTES: Nancy, just to share with the
22 board some experience from your career and practice,

1 from my own experience sitting on a public company
2 board, a \$3 billion a year organization, having an
3 audit committee and a finance committee, I recall that
4 if any of the committees had a lot of responsibility
5 outside -- and this addresses your comment,
6 Lillian -- a lot of activity outside of the normal
7 board sessions, it was the audit committee meeting with
8 the auditors, doing work not at the same time as the
9 board was meeting.

10 And I guess I'm saying in terms of conflict of
11 schedule, and our days are getting so full, and all
12 these issues that are being raised, I would expect that
13 this independent audit committee, if it is authorized
14 and created, would probably have a lot of duties in
15 between our meetings.

16 Is that not your professional experience?

17 MS. DAVIS: Yes. And I think that also in
18 another -- in a corporation setting or another
19 not-for-profit setting where you don't have an
20 inspector general's office, you might have an internal
21 audit function that you would interface with in
22 addition to the external auditors for the financial

1 statements.

2 I think here in LSC, their statement probably
3 is fairly stated simply because with an IG function,
4 that you do have an internal audit arm and they are
5 very active in helping to carry out the programs of
6 LSC. So I think that the audit committee would be very
7 active in that respect. I don't know what kind of time
8 requirements that would mean.

9 CHAIRMAN MCKAY: Herb?

10 MR. GARTEN: Would it be possible for you to
11 put together an outline, based upon what you see here
12 at LSC, of what the responsibilities and functions of
13 the proposed committee will be so we could have some
14 gauge as to how much time would be involved?

15 MS. DAVIS: I think it's still -- I can,
16 except that I still would be projecting some to you
17 all. The scope of an audit committee can be really as
18 broad as you would want it to be. For example, the
19 ethics function could very well be included.
20 Governance issues could be included.

21 It really depends on what kind of an umbrella
22 you want or whether you want it very targeted. You

1 wouldn't include some of these external
2 responsibilities. You'd include it with the audit
3 function.

4 MR. GARTEN: If we were targeted, would you be
5 able to put together a schedule or an outline or what?

6 MS. DAVIS: Basically, what the
7 responsibilities would be for the audit committee?

8 MR. GARTEN: Yes.

9 MS. DAVIS: Yes. I can do that.

10 MR. GARTEN: I would like to see that.

11 CHAIRMAN McKAY: As I indicated, I would
12 envision, Nancy, as well as these fine gentlemen at the
13 table and other staff assisting the ad hoc committee,
14 but certainly that list would be helpful for us on the
15 committee. But I see Nancy playing a role in advising
16 us collectively and individually on how to proceed with
17 respect to the audit committee function.

18 Well, I would just indicate that I've given it
19 some thought, and I'm certainly open for having my mind
20 changed by the collective wisdom of the board. But I
21 would support a separate committee as well, and I think
22 it would be an audit and ethics committee -- not

1 necessarily the title, but certainly the audit
2 committee would address ethics issues. It's set forth
3 in some of the materials we received. And as we
4 discussed yesterday, ethics is very important and it
5 should be one of the committee functions. And it seems
6 to me it fits in nicely with audit.

7 But by creating a separate committee, you
8 know, we're pretty darn busy. The finance committee is
9 pretty darn busy most of the time. And because this is
10 such an important issue, that is, the audit functions,
11 it just seems to me that by creating a separate
12 committee, it would allow us to focus on these audit
13 functions, which are separate and distinct from the
14 finance committee functions and quite important.

15 So my inclination is to support a separate
16 committee as well. But I would encourage us to have
17 the ad hoc committee address this in light of the other
18 issues and come back with recommendations to the board
19 before our next board meeting.

20 Are there any other comments or questions or
21 concerns on this subject?

22 (No response.)

1 CHAIRMAN McKAY: I'd like to thank you all for
2 your very good work. The materials that you received
3 I'm sure we all reviewed. I certainly studied it
4 carefully. I know it will be helpful to the ad hoc
5 committee. And I think we've made real progress on
6 this issue and on helping address a very important
7 item.

8 We've reached that point of the meeting for
9 public comment. Is there any public comment?

10 (No response.)

11 CHAIRMAN McKAY: Consider and act on other
12 business. Is there any other business?

13 (No response.)

14 CHAIRMAN McKAY: Consider and act on a motion
15 or an act of adjournment, a motion to adjourn, at
16 12:18.

17 M O T I O N

18 MR. FUENTES: So move.

19 MR. GARTEN: Second.

20 CHAIRMAN McKAY: All those in favor say aye.

21 (A chorus of ayes.)

22 CHAIRMAN McKAY: Opposed?

1 (No response.)

2 CHAIRMAN MCKAY: We're only behind by 18
3 minutes.

4 (Whereupon, at 12:18 p.m., the committee was
5 adjourned.)

6 * * * * *

7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22