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LEGAL SERVICES CORPORATION
BOARD OF DIRECTORS

MEETING OF THE
AUDIT COMMITTEE

Saturday, April 26, 2008
12:03 p.m.

The Marriott Hotel
3233 Northwest Expressway
Oklahoma City, Oklahoma

COMMITTEE MEMBERS PRESENT:
Herbert S. Garten, Chairman
Thomas R. Meites
Jonann C. Chiles
Frank B. Strickland, ex officio

OTHER BOARD MEMBERS PRESENT:
Lillian R. BeVier
Thomas A. Fuentes (by telephone)
David Hall
Michael D. McKay
Bernice Phillips
Sarah M. Singleton

1 STAFF AND PUBLIC PRESENT:

2 Helaine M. Barnett, President

Victor M. Fortuno, Vice President for Legal Affairs,

3 General Counsel, and Corporate Secretary

4 David L. Richardson, Treasurer and Comptroller,

Office of Financial and Administrative Services

5 Patricia D. Batie, Manager of Board Operations

Mattie Cohan, Senior Assistant General Counsel

6 Karen Sarjeant, Vice President for Programs and

Compliance

Jeffrey Schanz, Inspector General

7 Ronald "Dutch" Merryman, Assistant IG for Audits

Joel Gallay, Special Assistant to the Inspector General

8 David Maddox, Assistant Inspector General for

Management and Evaluation

9

Nancy Davis, Independent Public Accountant

10 (by telephone)

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

11 Don Saunders, National Legal Aid and Defenders

Association (NLADA)

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

2 (12:03 p.m.)

3 CHAIRMAN GARTEN: May I call to order the
4 Audit Committee meeting? I am Herb Garten, recently
5 appointed chair of the committee. And I refer you to
6 page 152 in your book, the agenda.

7 The first order of business, may I have a
8 motion to approve the agenda?

9 M O T I O N

10 MR. MEITES: So move.

11 MS. CHILES: Second.

12 CHAIRMAN GARTEN: All in favor, aye.

13 (A chorus of ayes.)

14 CHAIRMAN GARTEN: So moved and so passed.

15 I will give a brief report on the board's
16 establishment of the audit committee. It was
17 established in a telephonic meeting by resolution. It
18 took place on March 24, 2008.

19 At the same time that it was established, the
20 board approved a charter for the committee that I will
21 briefly review shortly. The committee
22 appointments -- it's a committee of three. Jonann

1 Chiles and Tom Meites will join me as members of the
2 committee.

3 The committee charter appears in your book on
4 page 153, and I'll briefly summarize what it contains.
5 The purpose I will read to you. "The purpose of the
6 committee," as provided in Section II, "shall be to
7 assist the board in fulfilling its responsibility to
8 ensure that the Corporation's assets are properly
9 safeguarded; to oversee the quality and integrity of
10 the Corporation's accounting, auditing, and reporting
11 practices; and to perform such other duties as assigned
12 by the board."

13 The charter provides for the committee to meet
14 at least four times each calendar year, but they may
15 meet more frequently at the call of any member of the
16 committee.

17 Resource-wise, all offices, divisions, and
18 components of the Corporation, referred to as
19 management, including the Office of the Inspector
20 General, shall cooperate with all requests made by the
21 committee for information and support. The committee
22 shall be given the resources necessary to carry out its

1 responsibility.

2 Roman numeral VI of the charter authorizes the
3 committee to undertake any action, basically, that it
4 feels necessary in order to fulfill its mission.

5 Section VIII details 16 different areas in which the
6 committee has responsibility or duties. It also has a
7 provision similar to what you heard earlier by the
8 chair of the finance committee dealing with the fact
9 that it shall, in conjunction with the finance
10 committee, perform a number of the duties that are
11 assigned to it.

12 The charter was thoroughly reviewed by a
13 number of individuals, including the Inspector
14 General's office, who had some recommendations that we
15 felt were very worthwhile and was incorporated in it.
16 And I might add that the cooperation extended to us by
17 the Inspector General has been very, very helpful and
18 that we look forward to working cooperatively with his
19 office.

20 If there are any questions from anybody
21 regarding the charter itself, I'll be glad to respond
22 to them.

1 (No response.)

2 CHAIRMAN GARTEN: Hearing none, we'll move
3 forward on the agenda. Pat, have you called --

4 MS. SINGLETON: Nancy's on.

5 CHAIRMAN GARTEN: Okay. Nancy is on the
6 phone.

7 MS. DAVIS: Yes. I'm here.

8 CHAIRMAN GARTEN: All right. We'll call on
9 you shortly.

10 Jeffrey Schanz, Inspector General, would you
11 come forward, please? Jeff, I was looking for you
12 earlier to explain that. I'd appreciate it if you
13 could condense the time.

14 MR. SCHANZ: Expedience is of the essence.

15 CHAIRMAN GARTEN: Thank you.

16 MR. SCHANZ: This is Jeff Schanz, the
17 Inspector General for the Legal Services Corporation.

18 CHAIRMAN GARTEN: Would you give us a general
19 summary of how you see your office and the audit
20 committee working in connection with the duties and
21 responsibilities that have been outlined in the
22 charter?

1 MR. SCHANZ: Yes. We intend to engage the
2 audit committee on many of our major finding areas, and
3 engage the audit committee also on the selection of the
4 external auditor, Nancy Davis, for the Corporation
5 audit.

6 Also, any issues that we need guidance on I
7 intend to present to the audit committee, and by virtue
8 of the audit committee, to the full board if the issues
9 are significant enough.

10 CHAIRMAN GARTEN: Good. Do you have any other
11 comments you'd like to make?

12 MR. SCHANZ: No. As you mentioned during the
13 charter process, we look forward to working with the
14 audit committee. It gives us another sounding board
15 for some of the work that we do.

16 CHAIRMAN GARTEN: And we appreciate the
17 cooperation, as I've said, that you've extended to us,
18 and we look forward to working with you.

19 MR. SCHANZ: Thank you.

20 CHAIRMAN GARTEN: And thank you for being
21 here.

22 MS. SINGLETON: May I ask a question,

1 Mr. Chairman?

2 CHAIRMAN GARTEN: Yes.

3 MS. SINGLETON: Jeff, when you said that you
4 would be working with the audit committee on major
5 findings, is that regardless of what the findings are
6 about? Is the audit committee going to be your vehicle
7 to get information to the board?

8 MR. SCHANZ: That hasn't been worked out yet.
9 Theoretically, yes, that would be the answer. But I
10 don't want the board to be surprised by any of the
11 things that the Office of the Inspector General
12 uncovers. Earlier today we talked a little bit about
13 the Nevada situation. That should have been ventilated
14 a little bit sooner than it was.

15 MS. SINGLETON: Well, I'm just wondering, if
16 things are not financial, will they still be going
17 through the audit committee, things that you may find?

18 MR. SCHANZ: No. Management is the first.
19 They're the audience to all the IG reports. So it
20 would be management that I would see as being the
21 primary vehicle of discussing things that they possibly
22 are in disagreement with with the board and/or the

1 audit committee.

2 I intend to use the audit committee, as I
3 mentioned, as a sounding board for some of the things
4 that we find, both fiscally and programmatically. But
5 by definition and by the audit committee charter, I'll
6 specify that yes, in answer to your question, it would
7 be primary fiscal issues.

8 CHAIRMAN GARTEN: Any other questions?

9 (No response.)

10 CHAIRMAN GARTEN: Thanks again for being here.

11 MR. SCHANZ: Thank you for the opportunity.

12 CHAIRMAN GARTEN: I'll call now upon our
13 independent public accountant, Nancy Davis, who's on
14 the phone with us. Nancy, I appreciate your being so
15 patient. You have seen the agenda, and we'd like your
16 comments regarding your perspective on the new audit
17 committee mission and how it fits into the work that
18 you're doing.

19 MS. DAVIS: Okay. I have reviewed the charter
20 very carefully. I think that it adequately covers key
21 areas that are important for an audit committee to
22 address. But I did want to just expand on a couple of

1 items.

2 I think that one of the central functions of
3 the audit committee is to increase accountability and
4 transparency for financial reporting throughout the
5 organization and to the public. And that concept of
6 accountability and transparency I think are key themes
7 for the audit committee.

8 But the committee should enhance communication
9 between the board and management, the internal auditors
10 with the IG, the external auditors related to financial
11 management problems, and then provide a vehicle for
12 resolving differences.

13 You have a unique role in that you work with
14 all these various parties, where the finance committee
15 primarily is engaged with management in accomplishing
16 their purpose and mission. But you have a number of
17 groups here, different audit groups as well as
18 management and the larger board, that you pull together
19 under your purview and responsibility, and work to
20 facilitate the communication between those parties to
21 the end that you increase the accountability and
22 transparency within the organization.

1 I also believe that, although not specifically
2 stated in the charter, that the audit committee should
3 also take an active role in the prevention, deterrence,
4 and detection of fraud, and encourage the organization
5 to establish and effective ethics and compliance
6 program.

7 Fraud and the risk of fraud in an
8 organization, as you well know, was one of the
9 catalysts in the post-Enron situation that raised the
10 awareness and the importance, the significance, of the
11 function of an audit committee in any organization.

12 So that was not specifically mentioned in the
13 charter, and I wanted to just bring it to the
14 forefront, that part of the risk management within the
15 organization is an awareness of the assessment and
16 management of the risk of fraud.

17 The scope and the responsibilities of the LSC
18 audit committee are somewhat broader than the typical
19 not-for-profit because there is an internal audit
20 function, if you will, within the Office of the
21 Inspector General. They have a unique relationship to
22 LSC as an organization. But it certainly will broaden

1 the nature of some of the things that you all will get
2 involved in because they will be looking at things
3 other than -- in other words, in most not-for-profits,
4 the audit function within the organization is targeted
5 primarily at the audit of the financial statements.

6 And I think that the audit breadth of things, financial
7 and otherwise, that you all maybe get involved in will
8 be expanded because of the presence of the Inspector
9 General's office within LSC.

10 I think that for an audit committee, that
11 there are two general, primary focuses that an audit
12 committee looks to. And one is that of internal
13 controls within the organization, and the other one is
14 the audit function.

15 And so within those broad umbrellas, while
16 it's not necessary for the audit committee to get
17 involved in the details of some of these areas as it
18 relates to understanding standards and requirements and
19 the proper application of those things, there are broad
20 concepts of understanding and terms, both in the
21 internal control environment and the audit function,
22 that the audit committee will have to become familiar

1 with as you go forward.

2 I believe that the Inspector General has
3 spoken to you all, and I brought up at the last meeting
4 I attended, the concept of the COSO internal control
5 framework, that this was a report issued by the
6 Committee on Sponsoring Organizations of the Treadway
7 Commission.

8 And when that report came out, it expanded the
9 definition of internal controls from three components
10 to five components: the control environment, risk
11 assessment, information and communication, control
12 activities, and monitoring. And so within the audit
13 function as well as management's responsibilities, all
14 evaluation and assessment of internal controls hangs on
15 those five components.

16 So I would recommend that this is an area that
17 the audit committee needs to become very familiar with.
18 The auditing standards after this report was issued
19 were modified to incorporate this new framework. And
20 so it provides the framework within we perform our
21 audits, and that's true for the Inspector General as
22 well.

1 So if you all get into this, just the terms
2 and the elements of -- as you learn more of the
3 internal control structure within LSC, you'll find that
4 it'll hang on these five components. And so it's an
5 important concept for you all to grasp and understand.

6 The other aspect of your responsibilities will
7 focus on the audit function itself. And it's important
8 that you understand what an audit is and what an audit
9 is not. And for example, the audit of financial
10 statements is designed to obtain reasonable rather than
11 absolute assurance. Some of these terms will be
12 important for you to understand going forward.

13 I would recommend that if you all have not
14 seen a copy of the Government Auditing Standards,
15 commonly called the Yellow Book, that a new revision of
16 the Yellow Book was issued in July of 2007. And if you
17 are familiar with it, I would recommend that you read
18 chapters 2 and 3. This is where some of the more
19 significant revisions were made in this latest
20 revision.

21 Chapter 2 addresses ethical principles in
22 government auditing, and chapter 3 is entitled General

1 Standards, but it includes topics of independence,
2 professional judgment, competence, and quality control
3 and assurance.

4 And just as one of your responsibilities per
5 the charter is to work with the IG to annually review
6 and confirm the independence of the external auditor, I
7 think it's important that you understand the concept of
8 independence that we operate under as it relates to
9 government auditing standards, and so that you would be
10 in a better position to do that review and evaluation,
11 that you would understand what independence means in
12 this context.

13 So I would recommend that the three of you
14 have a copy of the Yellow Book. It also -- there are
15 different types of audits. There are financial
16 statement audits. There are financial audits. There
17 are attestation engagements. There's performance
18 audits. And while you may not need to get into the
19 nitty-gritty of exactly what they are, but the IG's
20 office performs most of these types of audits, and I
21 think it would be important for you to understand the
22 distinction between them.

1 You all will be the ones that the new Auditing
2 Standard No. 114, "The Auditor's Communication with
3 Those Charged with Governance," which I reviewed with
4 you last time I spoke to you -- that this group, the
5 audit committee, will be the point people through which
6 we will be communicating. And we'll be engaging you in
7 the financial statement audit process as we move into
8 that this fall. And I'll speak more to that in a
9 minute.

10 But I also would recommend that a good
11 resource for you is the AICPA's website. It's
12 AICPA.org. If you go in there to that website and you
13 do a search on audit committee, it will take you to a
14 site. AICPA has an audit committee effectiveness
15 center.

16 And at that center, they have a toolkit for
17 not-for-profit organization audit committees. And it's
18 designed to provide tools for you all to be able to do
19 your job more effectively, especially when you're not
20 as familiar with some of the responsibilities that
21 you're undertaking.

22 There are numerous checklists and questions

1 that, as you gain an understanding of the internal
2 controls within the organization, it gives you some
3 guidance on types of questions you might ask upper
4 management to enable you to get a grasp and an
5 understanding of the control environment and how it
6 does operate within the organization.

7 And any of the pieces of that toolkit can be
8 readily downloaded. So I recommend that you check that
9 out. It would be a good resource for you if you're
10 looking for tools to help facilitate your job going
11 forward.

12 CHAIRMAN GARTEN: I think a lot of the
13 material that you've referred to we will circulate to
14 the members of the committee.

15 MR. MCKAY: And the whole board, hopefully.

16 CHAIRMAN GARTEN: If the whole board wants it,
17 certainly.

18 MR. MCKAY: Yes. I'd sure like to see it.
19 Thank you.

20 CHAIRMAN GARTEN: Certainly. Nancy, of course
21 you and I have talked, and I'd like the board to know
22 that we can tell from your comments about your

1 experience with audit committees. But if you'd like to
2 very briefly describe your experience in dealing with
3 audit committees for other organizations. You've had
4 experience in that area.

5 MS. DAVIS: How that has worked with other
6 organizations?

7 CHAIRMAN GARTEN: Well, your personal
8 experience.

9 MS. DAVIS: The formation -- I mean, I have
10 dealt with boards, numerous boards through the years.
11 The specific function of an audit committee is
12 something that many not-for-profits are just forming
13 now. They may have had a finance committee, as you all
14 have, but for some not-for-profits, having a formalized
15 audit committee is something that many of them are
16 going through the process as you are.

17 I have found that there's a learning curve
18 that needs to be addressed. But at the same time, I
19 think there is an easy way to address some of the
20 questions and you all to gain the understanding you
21 need to be effective in your role.

22 And I just maintain an ongoing communication

1 with those boards. When I have presented the financial
2 statements, I'll go through and explain the statements,
3 how they work, how to read the financial statements, if
4 you will, as well as discuss some of the issues.

5 Up until this year, for the most part the
6 relationship with the board or the audit committee has
7 been primarily at the end of the audit. Under SAB 114
8 now, the audit committee will begin to get involved in
9 the audit at the beginning of the audit.

10 For LSC, that is initiated with the scheduling
11 of what's called an entrance conference. That
12 generally happens in the fall. And we meet with
13 members of management and the IG and ourselves, and
14 this year it would be appropriate for you all to
15 participate as well.

16 CHAIRMAN GARTEN: Good. Well, we appreciate
17 your report, and we look forward to your advice and
18 consultation in the future. And we certainly will be
19 in touch.

20 Are there any questions for Nancy Davis from
21 any of the board members?

22 (No response.)

1 CHAIRMAN GARTEN: If not, we'll move on to the
2 next item on the agenda, and that is to consider and
3 act on development of a plan of action for the
4 committee.

5 First of all, we'll put together all the
6 references that Nancy has referred to. And I have a
7 few others that we will duplicate. And one of the
8 others is a best practices review issued December 6,
9 2007 by the Inspector General of the United States
10 Department of Defense. And it's quite a booklet.

11 And what I thought we'd start off with, and
12 have some big tasks in front of us, is to come up with
13 a recommended -- what they have as an appendix to this
14 report -- a committee charter evaluation checklist,
15 where they set forth an example of what are our
16 responsibilities? What action is taken?

17 And there's also, in conjunction with it, an
18 annual checklist of annual activity where they list the
19 various responsibilities of the audit committee, the
20 frequency within which the particular would take place,
21 and the actual quarter within the fiscal year in which
22 these items would be considered by the committee.

1 So I thought we would start with an attempt to
2 see how this checklist would work out, both the
3 evaluation and the timing of it, based upon our present
4 charter; and in connection with that, also ask for
5 comments from Nancy and from the Inspector General to
6 see that we're in synch with what they believe is the
7 timetable and also is the appropriate items for us to
8 consider.

9 Is there any questions with regard to this
10 agenda item from anybody?

11 MR. MEITES: Herb, are you going to
12 prepare -- well, you're going to circulate the Defense
13 Department --

14 CHAIRMAN GARTEN: I'm going to circulate that.
15 You're also going to have the full report.

16 MR. MEITES: Right. But are you or someone
17 going to prepare this checklist as --

18 CHAIRMAN GARTEN: I will attempt to set up the
19 checklist and ask for other committee members to
20 assist.

21 MS. CHILES: Yes.

22 MR. MEITES: If you can start it and circulate

1 it, that would be helpful.

2 CHAIRMAN GARTEN: That's what I plan to do.

3 MR. MEITES: Thank you.

4 CHAIRMAN GARTEN: All right. Any other
5 questions?

6 MS. CHILES: I don't have a question, but I do
7 have -- well, I guess maybe I have a request. In our
8 charter, Section VIII, item No. (5), it says that:
9 "The audit committee shall consult with the IG as to an
10 appropriate approach regarding communications and
11 meetings between the committee and the OIG."

12 I think it would be helpful if we could
13 address that item sooner rather than later in our work,
14 just to make sure that we're all on the same page with
15 respect to proper communications. I'm sensitive to the
16 Inspector General's independence, and I want to make
17 certain that we don't -- I want to make certain
18 everybody is comfortable and are working well together.

19 CHAIRMAN GARTEN: Well, I had that in mind
20 when I said we would circulate this checklist also.
21 And I think it would be -- it would encompass this
22 particular paragraph. And we'll get comments from the

1 IG and other board members.

2 MS. CHILES: Excellent. May we also have a
3 briefing, for example, on COSO? I was just introduced
4 to COSO about a month ago, and it's rather involved.

5 MS. SINGLETON: Mr. Chairman, I did ask if the
6 Inspector General would distribute to the board a
7 publication that he gave to some of us on COSO which I
8 found very useful in trying to understand the concepts.

9 MR. MEITES: For the benefit of the newest
10 member of the audit committee, it would be helpful if
11 this acronym were stated in full.

12 CHAIRMAN GARTEN: COSO stands for?

13 MR. MERRYMAN: Committee on Sponsoring
14 Organizations. I know that really helps.

15 MR. MEITES: What is this document that some
16 people are knowledgeable about but one member of the
17 audit committee doesn't have a clue?

18 MR. MERRYMAN: It is the internal -- I'm
19 sorry. My name is Ronald Merryman. I'm the assistant
20 Inspector General for audit. It is the internal
21 control framework that is most commonly used in the
22 United States for establishing a system of control,

1 internal control, within an organization, that looks
2 broadly at all risks within an organization and trying
3 to control risk and monitor risk.

4 And it was part of a Treadway Commission
5 effort to try to get common definitions and approaches
6 to internal control, to control fraud, and other
7 issues.

8 MR. MEITES: And that's the publication that
9 Nancy referred to in her comments?

10 MR. SCHANZ: That's correct. In addition,
11 it's what GAO used as their guide for reviewing the LSC
12 Corporation. They use the COSO framework. And we will
13 make that available to everybody, plus it will be my
14 pleasure to give everybody, every board member, a copy
15 of the Yellow Book.

16 CHAIRMAN GARTEN: That's fine. It will save
17 us a lot of copying.

18 MS. SINGLETON: Don't go overboard.

19 CHAIRMAN GARTEN: All right. We'll count on
20 you to distribute that one.

21 MR. SCHANZ: That's correct.

22 CHAIRMAN GARTEN: And the COSO.

1 MR. SCHANZ: Yes, sir.

2 CHAIRMAN GARTEN: Thank you.

3 Any other questions or comments?

4 (No response.)

5 CHAIRMAN GARTEN: Any public comments?

6 (No response.)

7 CHAIRMAN GARTEN: Is there any other business
8 for us to consider?

9 (No response.)

10 CHAIRMAN GARTEN: Hearing none, I'll ask for a
11 motion to adjourn.

12 M O T I O N

13 MR. MEITES: Noting it's 12:29, I move we
14 adjourn.

15 MS. CHILES: Second.

16 CHAIRMAN GARTEN: All in favor?

17 (A chorus of ayes.)

18 CHAIRMAN GARTEN: All right. That concludes
19 the audit committee meeting.

20 (Whereupon, at 12:30 p.m., the committee was
21 adjourned.)

22 * * * * *