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OFFICE OF LEGAL AFFAIRS

RULEMAKING OPTIONS PAPER

TO: Operations & Regulations Committee

FROM: Mattie Cohan, Senior Assistant General Counsel

DATE: January 22, 1010

SUBJECT: Rulemaking Options Paper – 45 CFR Part 1607 – Governing Bodies

The Operations and Regulations Committee (the Committee) has been considering recipient governing body governance issues and the role recipient boards have in ensuring that their organizations operate in conformance with LSC laws and regulations, particularly with respect to fiscal issues. To that end, a panel discussion on board governance featuring recipient board chairs was held at the January 2009 meeting of the Committee. Subsequently, a staff Board Governance Work Group (Working Group) was created to further research ways in which LSC could provide additional support to recipient boards. The Working Group surveyed all recipient executive directors and board chairpersons in May 2009. The Working Group reported to the Board on October, 2009, on the responses LSC received and the Working Group's analysis of those responses.[1] The Committee has now posed the specific question of whether LSC should consider amending its governing bodies regulation at 45 CFR Part 1607 to require recipient boards to have audit committees.

Background

The Current Regulation – 45 CFR Part 1607

The LSC Act requires recipients to have governing bodies, such as a board of directors. 42 U.S.C. §2996f(c). LSC has implemented this statutory requirement through regulations found at 45 CFR Part 1607. LSC's Part 1607 regulations are:

> designed to insure that the governing body of a recipient will be well qualified to guide a recipient in its efforts to provide high-quality legal assistance to those who otherwise be unable to obtain adequate legal counsel and to insure that the recipient is accountable to its clients.

[1] Interim Status Report on Issue of Grantee Audit Committees, LSC Board Governance Working Group (October 28, 2009) (hereinafter "*Working Group Report*"). For the Committee's reference a copy of this report is appended hereto.

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45 CFR §1607.1. Part 1607 is focused primarily on the composition of governing bodies. In particular, the regulation sets forth requirements (many based in statutory requirements) regarding the relative percentages of lawyers and clients who must comprise recipient boards, along with how such members are selected. 45 CFR §1607.3. There are also provisions relating to waiver of the composition requirements (§1607.6) and limitations on compensation to board members (§1607.5).

The regulation also provides some general requirements regarding the functions of the governing body:

> (a) A governing body shall have at least four meetings a year. A recipient shall give timely and reasonable prior public notice of all meetings, and all meetings shall be public except for those concerned with matters properly discussed in executive session in accordance with written policies adopted by the recipient's governing body.
> (b) In addition to other powers and responsibilities that may be provided for by State law, a governing body shall establish and enforce broad policies governing the operation of a recipient, but neither the governing body nor any member thereof shall interfere with any attorney's professional responsibilities to a client or obligations as a member of the profession or interfere with the conduct of any ongoing representation.
> (c) A governing body shall adopt bylaws which are consistent with State law and the requirements of this part. Recipients shall submit a copy of such bylaws to the Corporation and shall give the Corporation notice of any changes in such bylaws within a reasonable time after the change is made

45 CFR §1607.4. The regulatory history sheds little light on why LSC chose to provide for only these very general function requirements. The preamble to the first Final Rule (which was even less detailed that the current version, adopted in 1994), states only that

> [t]he Corporation believes that Formal Opinion 334 of the American Bar Association Committee on Ethics and Professional Responsibility (August 10, 1974) enunciates sound principles to guide a governing body in carrying out its responsibilities to a legal services program and its clients.

41 Fed. Reg. 25899 (June 23, 1976) at 25900. ABA Formal Opinion 334, however, is focused on the governing body's responsibilities and limitations with respect ensuring that the independent professional responsibility of the program attorneys is not infringed by the governing body. ABA Formal Opinion 334 at pp. 5-6. The Corporation does not appear at the time Part 1607 was adopted to have given significant consideration to mandating requirements for the governing body regarding corporate governance issue.

In 1994, LSC revised Part 1607 to incorporate specific reference to a governing body's "authority and responsibility inherent in their status as boards of nonprofit corporations." 59 Fed. Ref. 65249 (December 19, 1994) at p. 65253. The preamble states that the Board noted that the then-current regulation did "not recognize that general authority" but that the Board thought "it should do so." Id. Although the preamble to the final rule does not provide any further insight into the Board's thinking on this matter, the preamble to the NPRM on this matter notes that the

> Committee felt that the current regulatory language did not grant the governing body the general authority, for example, to hire and fire a program's executive director and that there should be language that granted that authority.

59 Fed. Reg. 30885 (June 16, 1994) at p. 30888. We can only infer that by 1994, LSC had become more concerned with the regulation's requirements regarding corporate governance and responsibility of a recipient board. Still, the amendment of the regulation in 1994 was to provide greater express responsibility and authority to governing bodies, but only in a general sense by acknowledging the board's general responsibility and authority under the laws of the state in which the recipient was incorporated. LSC did not, apparently, see a need for LSC to *require* more of boards but rather only for LSC to *recognize* their inherent corporate authority.

Non-profit Governance – Audit and Finance Committees – Current Corporate Standards

As noted in the *Working Group Report*:

> In recent years, the paradigm of financial management and accounting for non profits has shifted. The prevalent thinking is that all corporations, both for profit and not for profit, should have an audit committee and should separate the audit committee from the finance committee. Further, at least one member of the audit committee should meet the criteria of financial expert.

Working Group Report at pp. 1-2.[2] The report goes on to note that "It is also recognized that small and medium-sized nonprofit organizations may have different needs depending on the size and complexity of the organization." *Id*. at p. 2.

What follows is a extended excerpt from the *Working Group Report*, recapping the current standards for board governance. Footnotes are omitted, but may be accessed in the copy of the full report appended hereto.

> A highly regarded and frequently referenced report, *Strengthening Transparency, Governance and Accountability of Charitable Organizations* (Panel Report) was developed from the convening of a panel of national nonprofit experts brought together to make recommendations on accountability and oversight of charitable organizations to the Senate Finance Committee. According to the Panel Report, "[o]versight of the audit function is a critical responsibility of the board of directors, but boards must have the independence to assess the most

[2] The ABA Standards for Providers of Civil Legal Services to the Poor (2002 Edition) also recognizes that having an audit committee as a best practice and provides that a governing body "should consider establishing an active audit committee . . . ." Standard 7.1-3, Fiscal Matters.

cost-effective methods for ensuring that the organization's financial resources are managed responsibly and effectively." A review of the Panel Report shows that the board's responsibilities for overseeing the audit process include:

- Retaining and terminating the engagement of the independent auditor;
- Reviewing the terms of the auditor's engagement at least every five years;
- Overseeing the performance of the independent audit;
- Conferring with the auditor to ensure that the affairs of the organization are in order;
- Recommending approval of the annual audit report to the full board;
- Overseeing policies and procedures for encouraging whistleblowers to report questionable accounting or auditing matters of the organization;
- Approving any non-audit services performed by the auditing firm;
- Reviewing adoption and implementation of internal financial controls through the audit process; and
- Monitoring the organization's response to potentially illegal or unethical practices within the organization, including but not limited to fraudulent accounting.

The Role of an Audit Committee. No federal law addresses the role of audit committees of charitable organizations. State laws governing nonprofit corporations generally permit, but do not require, governing boards to delegate their duties, to establish committees, and to rely on their reports.

According to the AICPA, "internal control over financial reporting has always been a major area in the governance of an organization, and this importance has been magnified in recent years." The primary responsibility of the audit committee with respect to internal control is the system of internal control over financial reporting. The audit committee and the finance committee have distinct roles. As defined in Attachment C, a table prepared by the Nonprofit Risk Management Center, the audit committee addresses accounting, compliance, and regulatory matters. The finance committee addresses budgeting and planning. Both committees share some overlapping responsibilities. *See also* Attachment D, LSC Board Audit Committee Charter and LSC Board Finance Committee Charter.

The AICPA points to the role of the audit committee in the prevention, deterrence, investigation, and discovery or detection of fraud**.** The members of the audit committee should understand their role of ensuring that the organization has antifraud programs and controls in place to help prevent fraud, and aid in its discovery if it does occur, to properly fulfill their fiduciary duties of monitoring the financial reporting process; overseeing the internal control system; overseeing the internal audit and independent public accounting functions; and reporting findings to the board of directors.

No federal law requires nonprofit organizations to establish separate audit committees although at least one state adopted legislation requiring that the board of every charitable corporation required to register with the attorney general that receives annual gross revenues of $2 million, must appoint an audit committee.

According to BoardSource and Independent Sector, **"**[a]ll nonprofit organizations that conduct outside audits, particularly medium to large organizations, should consider forming an audit committee and should separate the audit committee from the finance committee."

In the Panel Report it was noted that "[o]rganizations with small boards of directors and limited organizational structures may not choose to delegate the audit oversight responsibility to a separate committee. This decision should be determined by the board of the organization. … Therefore, *audit committees should not be defined or required by federal law*." (emphasis in original.)

If a governing body decides not to establish a separate audit committee, the finance committee could include audit functions. There are authorities that recognize the prevalence of this structure. For example, BoardSource's *Nonprofit Governance Index 2007* reports that 54 percent of responding organizations have an audit committee. Of those, only 28% separated the audit committee from the finance committee.

The Working Group also notes the recent experience of LSC with the Government Accountability Office (GAO). In its August 2007 report on LSC, the GAO cited the National Council on Nonprofit Associations, stating that "an audit committee is generally responsible for the appointment, compensation, and oversight of the external auditor; handling board communication with the external auditor regarding financial reporting matters; and overseeing the entity's financial reporting and the adequacy of internal control over financial reporting. The audit committee also serves the important role of assuring the full board of directors that the entity has the appropriate culture, personnel, policies, systems, and controls in place to safeguard entity assets and to accurately report financial information to internal and external users."

> Notwithstanding the above observation, the GAO recommended that the LSC Board "establish an *audit committee function* to provide oversight to LSC's financial reporting and audit processes either through creating a separate audit committee or by rewriting the charter of its finance committee." (emphasis added.) Thus, the GAO did not require that the LSC Board establish a separate audit committee, but gave an option of either establishing a separate audit committee or changing the functions of the finance committee.
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> **Financial Expertise on Governing Body.** An important component of audit oversight includes having a person with financial expertise on the board of directors. The Panel Report, AICPA, and others recommend that at least one member of the governing body should have financial expertise, or access to financial expertise. The availability of financial expertise is helpful to the entire board, as well as to the finance committee and any audit committee. The Panel Report stated that "[c]haritable organizations should include individuals with some financial literacy on their board of directors in accordance with the laws of their state or as a matter of recommended practice." We agree. We also note that only 26% of the replies to the survey stated that their boards have a member who is a CPA or has a degree in accounting.
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> The importance of the board possessing financial expertise is also stressed when a board has a separate audit committee. The AICPA lists several essential attributes of financial expertise and several questions that should be used to assess whether an individual audit committee member or the committee as a whole possesses these attributes. Additionally the AICPA lists several alternative approaches if no individual member of the audit committee possesses the attributes required, including developing a relationship with the chief financial officer of a similar organization, engaging a financial professional to assist the audit committee, and pursuing a training program for audit committee members to develop the necessary financial expertise.

Working Group Report at pp. 3-7

LSC's Survey of Recipients – Audit and Finance Committees and Fiscal Oversight Experience among LSC Recipient Legal Services Programs

As reported in the *Working Group Report*:

> LSC grantees are diverse in funding and size, as well as distinct in other delivery model characteristics and attributes. A recent survey of LSC grantees revealed that while the vast majority of boards of directors are directly engaged in financial oversight, including the audit function, a smaller number have separate audit committees. The functions of an audit committee are essential and grantee boards

are required to ensure that these financial oversight responsibilities are being met. However, in certain situations, those functions might be efficiently and effectively handled by the board's finance committee.

There were 141 responses to the survey of grantee executive directors and board chairs, 51% of the 274 possible replies. The results showed that:

80% of the replies stated that their boards have finance committees and 74% have audit committees. However, there was no clear indication from the responses that the finance and audit committees were separate and 77% (50 of 65) of those that had combined committees, combined the finance and audit committees;

98% of the replies indicated that their boards regularly review financial statements showing actual income and expenditures compared to the amount budgeted. A slightly lower number, 94%, stated that this review is conducted by either the finance or audit committee;

93% of the replies stated that their boards meet with the program auditor at least once per year, either as a full board or through a committee;

71% of the replies responded that their boards, through the full board or an audit committee, actively participate in the selection of the auditor. In addition, some finance committees participate in the selection of the auditor;

84% of the replies stated that the boards have evaluated the existence or adequacy of internal control policies within the past two years;

80% of the replies declared that their finance committees, and 77% indicated that their audit committees, meet at least quarterly;

26% of the replies stated that their boards have a member who is a CPA or has a degree in accounting.

An additional review was conducted of grantee applications for LSC funding submitted in 2008 and 2009. The results of that review indicated that:

95% of the 42 programs submitting full applications in 2008 described some level of board engagement in budget planning and financial oversight;

92% of the 51 programs submitting full applications in 2009 described some level of board engagement in budget planning and financial oversight;

> 86% of the 51 programs applying in 2009 stated that they had an audit committee, however there was no indication as to whether the audit committee was separate or combined with the finance committee.
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> Taken together, the results of the survey and the review of funding applications submitted over the past two years demonstrate that the vast majority of grantee boards of directors are directly engaged in financial oversight, including being involved in audit committee functions, while a smaller number have separate audit committees.

Working Group Report at pp.2-3.

Options

Option 1 – Take No Action by Regulation – Encourage Audit Committees as a Best Practice

One option for the Board to consider would be to determine not to initiate a rulemaking (leaving Part 1607 as it is). The Board could select this option for procedural or substantive reasons.

The Board could elect to not engage in any substantive consideration of the matter at all in deference to the fact that the Board is in the midst of turnover. There are, currently, five nominees awaiting full Senate confirmation and another three whose nominations are still under consideration by the Senate Health, Education, Labor and Pensions Committee. With the coming change in Board membership, the Board could elect not to make any regulatory changes at this time, and instead to maintain the status quo pending the appointment of the new Board members. This would provide the greatest flexibility to the incoming Board members to adopt new policies of their own choosing with regard to this matter.[3]

On the other hand, given that there are still two positions for which nominations have not yet been made, that three of the nominees are still awaiting Committee action (let alone full Senate confirmation), and that the five nominations awaiting floor action continue to be subject to a hold, it is not at all clear when there will be a new Board (in whole or part) in place. Until such time as there is a new Board, the sitting Board members remain in place and have a continuing obligation to move the business of the Corporation forward. As such, there is a strong argument to be made that the current Board can and should move forward with substantive consideration and action on this issue.

[3] Of course, a new Board could choose to engage in rulemaking anyway, even if this Board does act to amend the regulation.

Assuming that the Board is going to consider the substantive merits of this issue, the Board could substantively determine that adopting by regulation a policy requiring recipient boards to have standing audit committees is not necessary. Given the diversity of LSC recipients as corporate entities it may not be necessary or even feasible for all LSC grantees to have separate audit committees. As described in some detail in the *Working Group Report*:

> LSC grantees are diverse in many different ways. For example, grantees' board sizes range from a high of 54 members to a low of 5 members. LSC funding to individual grantees ranges from $16.3 million to $88,800. In the survey responses, grantees describe a variety of successful strategies, policies, and structural changes that have substantially improved financial oversight of the program. . . .

Working Group Report at p. 6. Further, as the survey results and recent grant applications demonstrate, "the vast majority of grantee boards of directors are directly engaged in financial oversight, including being involved in audit committee functions [footnote omitted] while a smaller number have audit committees." *Id*. at p.3.

The best reason to require recipient boards to have freestanding audit committees would be to as a way to ensure that boards are engaged in close fiscal oversight of their organizations. Imposing such a requirement would appear to be appropriate if many or most recipients were not engaged in such activity. However, a majority of recipient boards in fact already have audit committees and a vast majority are already engaging in audit committee functions whether or not through a freestanding audit committee. Moreover, the LSC *Accounting Manual* already requires recipient governing boards to have financial oversight committees and sets forth duties and responsibilities for those committees. *See, LSC Accounting Manual*, section 1-7.[4] Under

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[4] LSC is currently in the process of revising its Accounting Manual. If adopted as proposed, section 1-7 of the Manual would be revised to provide: 1-7

> **Responsibilities of the Financial Oversight Committee or Committees**
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> Each recipient's governing body has a fiduciary responsibility to the program and must establish a financial oversight committee or committees. It is considered a best practice for governing bodies to have both a finance committee and a separate audit committee. It is also considered a best practice for a governing body to have at least one member who is a financial expert or for the board to have access to a financial expert.
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> The financial oversight committee(s) should, at a minimum engage in all of the responsibilities described below. In the event a governing body does not have a separate audit committee, the audit committee functions should be performed by the finance committee or another committee of the board.
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> The finance committee's role, subject to any requirements of state law:
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> 1. Revises budget and makes recommendations;
> 2. Reviews monthly financial statements with chief financial officer, controller and/or CPA
> 3. Reviews accounting and control policies and makes recommendations for changes and improvements;

these circumstances, a good argument can be made that adding a regulatory requirement to have an audit committee is unnecessary.

The imposition of an audit committee requirement would have no effect on the boards which already have audit committees. It is true that for those boards, complying with such a requirement would be easy. However, for those boards which do not have separate audit committees, such a requirement could be administratively burdensome particularly for boards with very small numbers of directors. Moreover since even the boards without separate audit committees report performing the functions of an audit committee, either through a joint audit/finance committee or at the full board level, the imposition of a committee requirement the lack of audit committees does not appear to be statistically correlated with a lack of effective fiscal oversight activity.

To the extent that the regulation did no more than require recipient boards to have audit committees, LSC would be easily able to check for compliance (if an audit committee exists, the

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4. Reviews the audited financial statements, management letter, and senior staff's response with staff and auditor;
5. Regularly reviews and makes recommendations about investment policies;
6. Coordinates board training on financial matters. Acts as liaison between full board and staff on fiscal matters.

Audit Committee
The audit committee's role, subject to any requirements of state law:
1. Hiring the auditor;
2. Setting the compensation of the auditor;
3. Overseeing the auditor's activities;
4. Setting rules and processes for complaints concerning:
a. Accounting practices
b. Internal control practices
5. Reviewing the annual IRS Form 990 for completeness, accuracy, and on-time filing and providing assurances of compliance to the full board.
6. Risk assessment, governance, compliance and ethics.

The duties and responsibilities of the financial oversight committee(s) should be defined in the recipient's bylaws or a governing body resolution or operating policies and procedures. In sum, the financial oversight committee(s) should:
(a) Provide assistance to the board in fulfilling its fiduciary responsibilities relating to accounting and reporting practices;
(b) Maintain communication between the board and the auditor;
(c) Institute any changes necessary to ensure proper oversight and control of funds;
(d) Guide the process of selecting the recipient's auditor, including recommending to the governing body the appointment of a particular auditor;
(e) Meet with the auditor to discuss, inquire about and review audit reports and financial statements, and the effectiveness of the recipient's management of financial and accounting functions;
(f) Review and recommend the approval of the recipient's annual budget; and
(g) Review the recipient's periodic management reports.

recipient is in compliance, if not, it is not in compliance). However, merely having an audit committee is meaningless unless the audit committee is engaging in meaningful fiscal oversight. As LSC already to have other measures by which it can determine whether a grantee is engaging in effective fiscal management, in particular the LSC Accounting Manual, it is unclear what additional advantage would be gained by either recipients or LSC by adding another layer of regulatory compliance requirements.

In lieu of the imposition of a regulatory requirement, there are other actions LSC can take to highlight the importance of appropriate fiscal oversight by recipient boards. LSC could issue guidance discussing this matter as something that has emerged as a best practice throughout the corporate world and encourage recipient boards to consider the establishment of audit committees, or the clear enunciation of audit committee functions as part of a joint audit/finance committee or a full board charter/bylaws, as appropriate to their circumstances. LSC could also provide guidance on the existing fiscal requirements of LSC so that boards understand what fiscal compliance requirements recipients are subject to, the impact that bad fiscal oversight can have not only on a recipient as an organization, but on client services, and the importance of the recipient board in setting the tone for the organization and in ensuring compliance. LSC could also encourage boards to obtain training and assistance in these matters, and perhaps even aid in that effort in some way.

Option 2 – Initiate a Rulemaking and Request the Development of a Notice of Proposed Rulemaking, with or without the Convening of a Regulatory Workshop or a Negotiated Rulemaking

The Board could follow the standard procedure for Rulemaking under the LSC Rulemaking Protocol and determine to initiate a rulemaking and direct Staff to develop a Notice of Proposed Rulemaking (NPRM) to require recipient governing bodies to have audit committees consistent with any policy guidance provided by the Board in consideration of the various policy concerns and options set forth herein, management's recommendations and comments from the field and other interested members of the public. An NPRM could be developed the Committee and the Board could meet at the next regularly scheduled meeting in April to approve the NPRM for publication. After comment period (typically 30 days), a Draft Final Rule would be prepared and the Committee and Board could take up a Draft Final Rule at the July meeting.[5]

The Board could include in its instructions a direction that a fact-gathering regulatory workshop be convened to discuss the policy choices and issues involved. Convening a regulatory workshop would allow for more informal consultation between LSC and interested parties before the development of an NPRM, but would also likely require additional time, delaying the consideration and adoption of a final rule.

[5] Special meetings could take place earlier than the regularly scheduled meetings, of course. Although with no particular deadline for action on this item, it is not clear that the trouble of scheduling and convening additional Committee/Board meetings would be worth the time and cost involved.

Alternatively, the Board could initiate a rulemaking and direct that it be conducted as a negotiated rulemaking. However, negotiated rulemakings are time, labor and cost intensive and generally reserved for issues where one is looking to make significant changes involving complex issues where a series of face-to-face negotiations will likely help the agency and the interested parties involved in the negotiation consider and work through a number of difficult factual and policy problems. Moreover, once the negotiated rulemaking is completed, LSC would still have to conduct a standard notice and comment rulemaking. The situation at hand does not appear to be a good candidate for a negotiated rulemaking.

As noted above, the best reason to require recipient boards to have freestanding audit committees would be to as a way to ensure that boards are engaged in close fiscal oversight of their organizations. Imposing such a requirement would appear to be appropriate if many or most recipients were not engaged in such activity, or were not doing an adequate job of such oversight. In that case, imposing a regulatory requirement could demonstrate to recipients the seriousness with which LSC takes such concerns. Moreover, by having a regulatory requirement for an audit committee, some boards could find additional motivation and justification for greater involvement in the oversight of their recipients. Recent experience with a few recipients has demonstrated that poor board involvement and oversight can be critical.

On the other hand, as discussed above the LSC *Accounting Manual* already requires recipients to engage in significant fiscal oversight; a majority of recipient boards in fact already have audit committees; a vast majority are already engaging in audit committee functions whether or not through a freestanding audit committee. Under these circumstances, a good argument can be made that adding a regulatory requirement to have an audit committee is unnecessary. Since even the boards without separate audit committees report performing the functions of an audit committee, either through a joint audit/finance committee or at the full board level, the imposition of a committee requirement the lack of audit committees does not appear to be statistically correlated with a lack of effective fiscal oversight activity.

Another consideration, as noted above, is that for those boards which do not have separate audit committees, such a requirement could be administratively burdensome, imposing additional committee assignments and work, which could be particularly difficult for boards with very small numbers of directors. One way to ameliorate the potential burden on recipients, especially ones with very small boards, would be to include in any revised regulation requiring audit committees a waiver provision for recipients for whom the establishment and use of a separate audit committee would present a significant burden. This way, LSC could have a general requirement for audit committees, while preserving the flexibility to provide for waivers in appropriate cases. This does raise a question, however, of exactly what the standards would be for such a waiver. Moreover, the processing of waiver requests would require staff time and effort, which, it could be argued, might be put to better use in enforcing the existing requirements without an additional layer of regulation and process.

Finally, since merely having an audit committee is meaningless unless the audit committee is engaging in meaningful fiscal oversight, if the Board wishes to impose a regulatory requirement for audit committees, the Board may wish to consider whether additional substantive standards for the work of such committees should be adopted. For example, should audit committees be required to be distinct from finance committees? Should audit committees include someone with specific financial expertise?[6] If so, should that expertise be someone on the Board, or would the use of a consultant or volunteer in this capacity be sufficient? Should the regulation specify the types of functions and activities LSC expects audit committees to be performing and if so, what are they? These are not necessarily simple questions and, given the diversity of LSC's recipients, the answers to some or all of these questions may differ for different recipients. This may suggest that the issues of concern to the Committee are neither sufficiently addressed by the simple imposition of an audit committee requirement nor susceptible of a standardized solution imposed by a one-size-fits-all regulation.

Option 3 - Initiate a Rulemaking and Request the Development and Publication of an Advance Notice of Proposed Rulemaking

Another option would be to initiate a rulemaking the Board could direct staff to develop and publish for comment an Advance Notice of Proposed Rulemaking (ANPRM). This action would be most appropriate if the Board was not yet convinced one way or another about the merits of imposing an audit committee requirement by regulation, yet wanted a formal, public way to obtain additional, broader input. An ANPRM often does not set forth specific proposed regulatory text changes, but instead often sets forth questions and policy options upon which it seeks comment that the agency may formally take under consideration. After receiving comment on an ANPRM, the Board would decide whether to proceed with the rulemaking and provide policy guidance for the development of an NPRM or whether to close the rulemaking without any further action. The advantage of this course is that is allows for additional input at the early stages of the Board's consideration of possible regulatory amendment. The disadvantage is that it does take longer than a traditional notice and comment rulemaking. However, in this case, since there is no statutory deadline against which LSC is working, taking additional time does not appear to present a significant problem. Also, depending on when the Senate acts on the various nominees, the development of an additional record could be of use to the new Board members if they inherit this issue.

If the Board were to favor this option, the questions the ANPRM should address would appear to be the ones set forth above: Should audit committees be required to be distinct from finance committees? Should audit committees include someone with specific financial expertise? If so, should that expertise be someone on the Board, or would the use of a consultant or volunteer in this capacity be sufficient? Should the regulation specify the types of functions

[6] Alternatively, the board could consider requiring, in lieu of a separate audit committee, a recipient governing body to include a person with financial expertise (such as an accounting degree and/or CPA certification). Given the statutory requirements for board composition which leave recipients with few board positions which may be filled by non-lawyers or non-client eligible members, it may be difficult for recipients to being able to find qualified board members with financial expertise within the confines of the composition requirements. If the Board wished to pursue a requirement along these lines, it might also consider the propriety of a waiver requirement allowing of alternative methods, such as having a consultant or advisor who is not a member of the board, for a governing body to avail itself of the necessary expertise.

and activities LSC expects audit committees to be performing and if so, what are they? Should there be a waiver requirement? If so, what standards should apply to such a waiver process?