

LEGAL SERVICES CORPORATION
BOARD OF DIRECTORS

MEETING OF THE
AUDIT COMMITTEE

OPEN SESSION

Sunday, October 20, 2013

4:50 p.m.

Renaissance Pittsburgh Hotel
107 Sixth Street
Pittsburgh, Pennsylvania 15222

COMMITTEE MEMBERS PRESENT:

Victor B. Maddox, Chairman
Harry J.F. Korrell, III
Gloria Valencia-Weber
David Hoffman (by telephone)
Paul Snyder (by telephone)
John G. Levi, ex officio

OTHER BOARD MEMBERS PRESENT:

Sharon L. Browne
Julie A. Reiskin
Father Pius Pietrzyk, O.P.
Martha Minow

ALSO PRESENT:

James J. Sandman, President

STAFF AND PUBLIC PRESENT:

James J. Sandman, President

Richard L. Sloane, Chief of Staff & Special Assistant
to the President

Lynn Jennings, Vice President for Grants Management

Rebecca Fertig, Special Assistant to the President

Janet LaBella, Director, Office of Program
Performance

Carol A. Bergman, Director, Office of Government
Relations and Public Affairs

Carl Rauscher, Director of Media Relations, Office of
Government Relations and Public Affairs

Ronald S. Flagg, Vice President for Legal Affairs,
General Counsel, and Corporate Secretary

Jeffrey E. Schanz, Inspector General

Ronald "Dutch" Merryman, Assistant Inspector General
for Audit, Office of the Inspector General

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

Thomas Coogan, Assistant Inspector General for
Investigations, Office of the Inspector General

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

Lora M. Rath, Deputy Director, Office of Compliance
and Enforcement

Allan J. Tanenbaum, Non-Director Member, Finance
Committee (General Counsel, Equicorp Partners)

Terry Brooks, ABA

Chuck Greenfield, National Legal Aid and Defender
Association (NLADA)

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 (4:50 p.m.)

3 CHAIRMAN MADDOX: So we are going to go ahead
4 and get started with the Audit Committee. I would like
5 to call the Committee to order, take a call of the
6 roll.

7 We have Gloria?

8 MS. VALENCIA-WEBER: Present.

9 CHAIRMAN MADDOX: Harry?

10 MR. KORRELL: Present.

11 CHAIRMAN MADDOX: Anybody on the phone?

12 David? I'm sorry?

13 MR. SNYDER: I am sorry. Paul Snyder. Hi,
14 Vic.

15 CHAIRMAN MADDOX: Greetings, Paul. Thank you
16 for joining us. Do we have --

17 MR. HOFFMAN: Hi, everybody. It is David
18 Hoffman.

19 CHAIRMAN MADDOX: Ah. Thank you for joining,
20 David.

21 We have the entire Committee present, and so I
22 will call the Committee to order.

1 M O T I O N

2 CHAIRMAN MADDOX: And the first order of
3 business is the approval of the agenda. Is there a
4 motion?

5 MR. KORRELL: So moved.

6 CHAIRMAN MADDOX: And a second?

7 MS. VALENCIA-WEBER: Second.

8 CHAIRMAN MADDOX: All in favor?

9 (Chorus of ayes.)

10 CHAIRMAN MADDOX: Hearing no objections, the
11 agenda is approved.

12 M O T I O N

13 CHAIRMAN MADDOX: Second item of business is
14 approval of the minutes of the Committee's July 2, 2013
15 meeting. A motion?

16 MS. VALENCIA-WEBER: I move to approve.

17 CHAIRMAN MADDOX: Is there a second?

18 MR. SNYDER: Second.

19 CHAIRMAN MADDOX: Thank you, Paul.

20 All in favor?

21 (Chorus of ayes.)

22 CHAIRMAN MADDOX: Hearing no objection, the

1 approval of the July 2nd minutes is passed.

2 M O T I O N

3 CHAIRMAN MADDOX: The third item is the
4 approval of the minutes of our July 21st meeting. A
5 motion to approve?

6 Gloria, is there a --

7 MS. VALENCIA-WEBER: Chair, we need to correct
8 the name of the auditing organization, I believe, on
9 page two. Is that correct?

10 CHAIRMAN MADDOX: The auditing organization?

11 MS. VALENCIA-WEBER: Under -- after "Inspector
12 General gave the briefing, and the auditor will have a
13 contract for another year." Is that correct spelling
14 for WithumSmith+Brown? Maybe I have it wrong.

15 CHAIRMAN MADDOX: Yes, I am not sure that is
16 the correct spelling. It is -- I don't know. If
17 anybody knows how to spell the name of our auditing
18 firm -- it sounds like Dutch is going to check that for
19 us.

20 (Pause.)

21 CHAIRMAN MADDOX: How do we spell Withum,
22 Dutch?

1 MR. MERRYMAN: W-I-t-h-u-m.

2 CHAIRMAN MADDOX: Okay. Well, then, it sounds
3 like that is the correct spelling.

4 MS. VALENCIA-WEBER: Okay. And it is in that
5 spacing and all?

6 MR. MERRYMAN: No space between --

7 MR. SNYDER: Yes, I just -- I Googled it, and
8 it is the way it shows up.

9 CHAIRMAN MADDOX: Okay.

10 MS. VALENCIA-WEBER: Okay.

11 CHAIRMAN MADDOX: Well, then, is there a
12 motion go approve the minutes?

13 MS. VALENCIA-WEBER: I will move to approve.

14 CHAIRMAN MADDOX: Okay. A second?

15 MR. SNYDER: Second.

16 CHAIRMAN MADDOX: All in favor?

17 (Chorus of ayes.)

18 CHAIRMAN MADDOX: Hearing no objection, the
19 minutes of the July 21st meeting are agreed to.

20 So, our first substantive matter, item 4(a),
21 the Risk Assessment Memo. We have a short memo from
22 the treasurer/comptroller, David Richardson, concerning

1 the risk assessment matrix that has been prepared. I
2 see David is at the table.

3 David, is there anything you need to add to
4 this?

5 MR. RICHARDSON: There is not, sir. We have
6 had a great deal of discussion about the risk matrix.
7 We have made some adjustments based on comments that we
8 have received from Board members in regards to
9 assignments and different areas.

10 So, we are presenting it to you for acceptance
11 now in the form of a resolution here, just stating that
12 this will be a document that will be used. And as it
13 is needed to be revised here and there, we will bring
14 it back to the Committee to make it a live document,
15 one that is used throughout the year to guide the
16 Committee's activities and those of the Corporation.

17 CHAIRMAN MADDUX: So, David, we have -- in the
18 matrix we have the date of last review and the date of
19 next review. How do those columns -- how will they
20 work, in practice?

21 MR. RICHARDSON: In the original review that
22 we had, we had an area where we placed the last review

1 and took it out at this point, thinking that we would
2 be moving this forward. But we will review with
3 management, with the President and the Inspector
4 General. We have set up a Risk Committee, and we will
5 be discussing with you, as Chairman of the Audit
6 Committee and chairmen of other committees, to
7 determine what reports will be given at the different
8 meetings. And then we will be completing the matrix
9 here, as far as the dates that items will be submitted
10 to the different committees.

11 CHAIRMAN MADDOX: So, assuming that this is
12 adopted by the Board, the matrix will be available
13 online somewhere on our website or internally?

14 MR. RICHARDSON: Yes, sir.

15 CHAIRMAN MADDOX: And we would see, then, when
16 any particular area was reviewed last, and will be
17 reviewed next?

18 MR. RICHARDSON: That is correct, sir.

19 CHAIRMAN MADDOX: Okay. Is there any
20 discussion from the Committee about the matrix?

21 MR. HOFFMAN: Vic, this is David. I just had
22 a -- just looking at the -- page seven of the matrix

1 and page eight of the matrix, I saw that there were a
2 couple of items that we have been spending time
3 discussing, where I didn't see the -- I figured the
4 matrix would allow for those contingent discussions
5 anyway, but I just wanted to confirm that.

6 Page seven lists grantee oversight by LSC and
7 IPA, including rigorous compliance oversight and
8 improved IPA oversight, and providing recommendations
9 for the IG as one topic. And then, the next page, page
10 eight, has a grantee operations as a topic, including
11 major misuse of grant funds. Both of those seem like
12 topics that, in addition to other Committee handling,
13 would be appropriate for the Audit Committee to be
14 discussing from time to time, including discussions
15 with the IG Office of Management.

16 I just wanted to confirm that that
17 understanding was right. I think that, if that is
18 right, it probably is prudent to add the Audit
19 Committee to those topics, in addition to the committee
20 that is listed. If it doesn't matter because we still
21 have the ability to do it because the matrix allows for
22 flexibility, I don't think it matters that much. But

1 that was my question.

2 CHAIRMAN MADDUX: No, I think it is a good
3 question, David. I am not sure if we had discussed
4 that in our previous meeting. But it is -- seems to be
5 certainly part of the core constituency of the Audit
6 Committee to be concerned about the major use of funds,
7 not necessarily in grant funds. Some of the other
8 issues there, failure of internal controls, for
9 instance, might easily be under the Audit Committee's
10 review, as well.

11 I don't know of any intention that we would be
12 limited in any way from continuing to discuss those
13 items. Was there any discussion internally, David,
14 about the Audit Committee and its involvement with
15 those areas?

16 MR. RICHARDSON: No, sir, there was not. But
17 certainly as we produce reports to other committees,
18 their practice has been to give them to the full Board,
19 so each member will get the reports. And as we are
20 discussing things with different committees that -- for
21 instance, if something like this comes up, I am sure
22 that we would talk with you as to what type of report

1 you would like to see in the Audit Committee if there
2 is something ongoing that we need to continue to report
3 to two committees.

4 CHAIRMAN MADDUX: That seems right to me. I
5 think that the Audit Committee's charter would
6 certainly continue to be in effect, notwithstanding the
7 allocation of any particular risk under the risk
8 matrix, would be my thought.

9 David, does that make sense?

10 MR. HOFFMAN: Yes. Like I said, I don't think
11 it is a big deal, as long as -- I mean I wouldn't want
12 the matrix to operate so that it prevents us from
13 having the kind of discussions we have been having with
14 the IG and management. I assume that it didn't. So I
15 really defer to you, Vic, about whether you care about
16 changing it or not. It was a question in my mind, and
17 however you want to proceed is fine with me.

18 CHAIRMAN MADDUX: Well, I think that, to the
19 extent that the risk is identified as grantee
20 operations, it really does seem to be that it is
21 appropriately delegated to the Promotion and Provision
22 Committee would be my thoughts.

1 So, I don't know if others have any different
2 thoughts on it. I am prepared to leave the matrix the
3 way it is. John?

4 MR. LEVI: We have a new name.

5 CHAIRMAN MADDOX: Right, whatever the new name
6 will be.

7 Okay, all right. Well, are there any other
8 comments or thoughts about the matrix, itself?

9 (No response.)

10 CHAIRMAN MADDOX: If not, I think the next
11 item of business is for us to consider and act on the
12 resolution.

13 MR. RICHARDSON: Mr. Chairman?

14 CHAIRMAN MADDOX: Yes.

15 MR. RICHARDSON: I am sorry. Resolution
16 is -- we need to have your Committee adopt a
17 resolution?

18 CHAIRMAN MADDOX: Right, right. I was going
19 to move to the next item, which is the resolution for
20 risk management oversight, which I think is item 48 on
21 our agenda. You want to address that, David?

22 MR. RICHARDSON: Yes, sir.

1 MR. RICHARDSON: We have put together this
2 as -- basically says whereas it is an ongoing risk,
3 management responsibility of -- management has
4 identified the risk of facing LSC and has set forth a
5 risk matrix attached hereto. Instead of reading the
6 whole thing, I just wanted to say that this will be a
7 live document, as we have talked about. As things do
8 need to change, we will bring it back to the Committee
9 and to the Board. But we ask that you adopt a
10 resolution as presented at this point.

11 MR. FLAGG: Mr. Chairman, just to be clear, I
12 think what we are really asking, and what the
13 resolution really addresses, is the allocation of these
14 risk areas to different committees.

15 As David has said, the matrix is going to
16 change, and the strategies that are set forth in the
17 matrix are going to change, as we are having these
18 reports with you, as we are consulting as we do with
19 the IG. So, I think the real key issue is for
20 the -- until it is changed, who should be the recipient
21 of the reports in these various areas.

22 CHAIRMAN MADDOX: Sure.

1 MR. FLAGG: And that is really what is the
2 topic of the resolution.

3 CHAIRMAN MADDOX: All right. So we will be
4 asking the full Board to adopt the matrix, which itself
5 allocates the various risks that have been identified
6 to the various committees.

7 MR. FLAGG: Right.

8 CHAIRMAN MADDOX: So, is there any discussion
9 of the resolution?

10 MR. HOFFMAN: Again, Vic, just to be clear,
11 what we are, as the Audit Committee, recommending the
12 Board -- and they will -- the matrix. And then they
13 are going to pass this resolution, theoretically, that
14 is on page 115.

15 CHAIRMAN MADDOX: Correct.

16 MR. HOFFMAN: Okay.

17 CHAIRMAN MADDOX: So, Gloria?

18 M O T I O N

19 MS. VALENCIA-WEBER: I move that we adopt the
20 resolution and pass it to the whole Board.

21 CHAIRMAN MADDOX: Is there a second?

22 MR. KORRELL: Second.

1 CHAIRMAN MADDOX: So the motion has been made
2 and seconded. All in favor of adopting the resolution?

3 (Chorus of ayes.)

4 CHAIRMAN MADDOX: Any opposed?

5 (No response.)

6 CHAIRMAN MADDOX: Hearing no objection, then,
7 our Resolution for Risk Management Oversight is
8 adopted. And we will submit it to the full Board at
9 our Board meeting on Tuesday.

10 That takes us, then, to item number five,
11 which is the "Oversight of Risk Management: Management
12 Discussion of Internal Financial Controls." So we have
13 a panel of Jim Sandman, our President, Ron Flagg, our
14 general counsel, and David Richardson, our comptroller.

15 Gentlemen, I turn it over to you.

16 MR. SANDMAN: Thank you, Vic. The Committee
17 has asked that management report regularly on different
18 components of our risk management program. Today's
19 presentation will be on internal financial controls. I
20 would like to make a few introductory comments, and
21 then turn it over to Dave Richardson, who will present
22 a number of the details of our internal financial

1 controls.

2 Our Inspector General always emphasizes the
3 importance of tone at the top. And I do my best to set
4 a tone of strict financial responsibility within LSC,
5 and to communicate that to all of our managers. We are
6 doing a number of things internally currently to follow
7 through on that. We are doing a comprehensive and
8 ongoing review of risk areas. I have established an
9 Internal Risk Management Committee, which consists of
10 Lynn Jennings, Dave Richardson, Ron Flagg, Carol
11 Bergman, Janet LaBella, Lora Rath, Peter Campbell, and
12 me. We are the people who are responsible for the
13 areas within LSC that are most likely to raise
14 significant risk issues under the risk matrix that the
15 Committee was just discussing.

16 We have taken a number of proactive steps
17 recently to enhance internal controls and the
18 monitoring of internal controls. As Ron Flagg
19 mentioned during the meeting of the Governance
20 Committee, we have an ongoing review and revision of
21 all of our policies bearing on internal controls, such
22 as the Conflict of Interest Policy.

1 Earlier, at the end of last year, I requested
2 that the Office of Inspector General conduct a fraud
3 vulnerability assessment of LSC headquarters and to
4 report the results to me. I did that because I was
5 impressed with the briefings that OIG did for the Board
6 on fraud vulnerability assessments of grantees, and
7 asked Jeff Schanz whether OIG had ever done a fraud
8 vulnerability assessment of LSC, the corporate entity
9 itself. And when he said that they hadn't, I asked if
10 they would.

11 OIG did a very helpful review of fraud
12 vulnerability at headquarters, made some
13 suggestions -- for example, that my travel expenses and
14 leave use be subject to review by the appropriate
15 committees of the Board. I now regularly send
16 quarterly reports about my reimbursed expenses and
17 leave usage to committees of the Board. Made several
18 other recommendations, all of which we adopted.

19 We are doing training on internal controls and
20 policies such as training about our procurement and
21 contracting procedures. As a result of some reviews by
22 OIG, I came to the conclusion that we were not doing

1 the job internally that we needed to, to comply with
2 our own internal procurement policies, and that we
3 needed to educate all of our managers about those
4 policies and come up with a training protocol that
5 would include checklists and very specific guidance
6 about each step that is required in the procurement
7 process.

8 Ron Flagg led that exercise and worked closely
9 with the Office of Inspector General on coming up with
10 training materials: a presentation to be made to all
11 of our managers -- which, I believe, now all managers
12 have concluded.

13 We plan to do ongoing management testing of
14 internal controls, not just depend on our Inspector
15 General to come in periodically and do their tests of
16 whether we are doing what we should be doing, but
17 voluntarily on our own to undertake periodic reviews of
18 our compliance with our own procedures.

19 Dave will address the specifics of our
20 financial controls. That is the focus of our
21 presentation today.

22 MR. RICHARDSON: Thank you. I should have

1 introduced myself before. My name is David Richardson;
2 I am the treasurer of the Corporation.

3 As we look at the financial controls that we
4 have in place, these plans that we put in place, and
5 the risk that we are trying to address, are -- we put
6 procedures in place to try to help to mitigate these
7 particular risks. One of the ways that we do that is
8 something that we started -- that we are starting
9 tomorrow with our financial audit. The auditors,
10 WithumSmith+Brown came for a week in September. And,
11 of course, the annual financial audit of our records is
12 a key component within our risk assessment process.

13 Within my office, each employee has
14 responsibility that they perform monthly, as far as
15 things like bank reconciliations, grants, management
16 processes, as far as the grant expenses, the grants
17 payables, how we issue checks. And we go through a
18 training process on those twice a year. All this
19 culminates, and then is reviewed by the audit, and then
20 we have our financial -- audited financial statements
21 done.

22 Some of the procedures that we do -- for

1 instance, I got a call this week. We are looking at
2 the grants for 2014. And after the appropriation
3 process of the last few weeks, and the shutdown, and
4 now the continuing resolution, we confirmed with the
5 Office of Information Management the amount of grant
6 money that is available for the programs.

7 We do that in writing each year, so that we
8 make sure that the correct amount is being broken out
9 to our grantees. Office of Information Management does
10 that breakdown; they provide it to us. And there is a
11 verification process that goes on. And we make sure
12 that the numbers are verified and checked. They do it
13 a couple of times, we do it a couple of times. But
14 when you are talking about this year, \$316 million, the
15 bulk of our money, we want to make sure we get it
16 right. So we go through this review process to make
17 sure that we are awarding the correct amount of money.

18 Additionally, with -- the TIG Awards have the
19 same process, where Glenn and the folks who are running
20 the technology initiative grants, they call, I usually
21 will respond with an email saying, "This is the amount
22 of money available for the TIG Awards."

1 So, again, we have a check-and-balance in
2 place. They get the monthly reports that shows how
3 much money is available, but then I confirm in writing
4 to them how much money they should be awarding. And it
5 is a good process.

6 We did have -- about three years ago they
7 reversed the numbers. They were so close, we had an
8 amount of, like, \$7.5 million that was to be awarded in
9 TIG grants. It was because of two years' worth of
10 grants. We give \$3.3 million, and there
11 was -- actually, reverse. We give \$3.6 million, and
12 there was an amount left less than half. Well, when
13 they give the awards, they give \$150,000 too much. So
14 we had to step in, reduce the grants, and get
15 everything correct. So we put this procedure in place
16 so that we don't face that again.

17 Each quarter the staff produces the analysis.
18 They are expected to do the monthly, but we do give
19 them a little bit of leeway during the first part of
20 the year. Especially right now, we are going through
21 the audit, everything is being checked. And we have
22 confirmed the amount of money that will be given. So,

1 in March, all of the accounts are to be reconciled, as
2 far as the grant expense and grants payable, and we
3 have that check-and-balance in place to make sure that
4 we are doing it appropriately, and the money is going
5 out appropriately.

6 We reconciled the amount of money that we pull
7 out of treasury each month to make sure that everything
8 is in balance, and we follow that and document.

9 The key thing here in any type of risk
10 management is documenting what you are doing. To say,
11 "Yes, I did it" and to a blank space without any type
12 of signature, any type of control in place, is about
13 what it is worth. So we document everything in
14 writing.

15 The trainings that we do. Last year we do a
16 grants training process, and I go through with the
17 people who are involved with our grants process, and we
18 verify what period we want the grants to be awarded in,
19 when the payments are made, and we make sure that
20 everybody is on the same page, so that we get the
21 correct information. Again, documenting our procedures
22 so that we make sure that we get it right.

1 Banks are reconciled monthly. We have a small
2 staff. October -- we have already done September, we
3 have given that to the auditors. But it may be
4 December before we do October. Because of the small
5 staff, we have to prepare for the audit, prepare
6 statements, continue everything running. So there is a
7 little bit of a lag at the first of the year, but then
8 we stay on top of it month after month after that, to
9 the point where we know that we are controlling our
10 cash and we have got our internal controls working
11 appropriately.

12 Any time that you are dealing with money, the
13 biggest thing that we look at, of course, is -- in our
14 particular situation -- are the grants. The next is
15 payroll. Payroll, any time that there is a change in
16 payroll, it comes through a personnel action. That is
17 the control figure that we -- item that we use there.
18 We get a personnel action for a new hire, for somebody
19 that is separating the Corporation, or for a raise.
20 Nothing takes effect until we get a signature from the
21 HR director, from the director who is making the
22 recommendation, and the President signs off, so that we

1 have those controls in place to make sure that
2 everybody is aware of what is going on before then we
3 take that and react and move forward with it.

4 Those are the key items that we have over
5 grants and payroll, which are the two biggest expenses
6 that we have. Jim mentioned the contracting
7 procedures. Any time that we are contracting for funds
8 to go out to purchase goods or services, we have a
9 process where the director of an area can solicit
10 different levels where we have arrangements made.

11 If somebody is buying something up to \$3,500,
12 or they have a maintenance agreement, or anything like
13 that, those that can react on -- we ask that they look
14 at the General Services Administration, Small Business
15 Administration, small, disadvantaged business. What we
16 are trying to do is get the best value. We use those
17 two, and then we can get a third or a -- more people
18 looking at it when we have specialized services, people
19 that do the type of work. We don't necessarily award a
20 contract to the lowest bidder. But what we are trying
21 to do is get the best value for the Corporation.

22 When you get 3,500 to 10,500, we have an

1 informal process where we basically award contracts on
2 the basis of three bids. Those bids can be by
3 telephone, they can be by Internet, reviewing the
4 Internet page, getting the prices of the goods, and
5 documenting what you do. They can also be done a lot
6 of times by email. When you call somebody, they will
7 respond by email. In each of these cases, again,
8 documentation is the key. When you look at the
9 contracting, all contracts, then, are reviewed by the
10 Office of Legal Affairs.

11 And I should back up. One thing. Before we
12 do any type of purchasing for goods or services, we
13 need a statement of what the need is, what the purpose
14 of the contract or the purchase is going to be. So we
15 are looking to make sure that there is -- everybody is
16 on the same page as to if there is a service needed,
17 that there is a document that shows this need and how
18 we will proceed to go about it.

19 When we get those bids, three bids, then we
20 have a matrix that we ask them to evaluate and
21 determine how they made the selection as to the one
22 that will be receiving the contract. All this

1 information goes to Legal Affairs, the expression of
2 need.

3 We also ask them to review their budget. They
4 will call me on their budget to make sure that there is
5 enough money in their budget for the expenditure of
6 goods or services that they are wanting to procure.
7 And this is documented and goes to OLA, where they will
8 review the contract, and they will sign off. It will
9 then come to me, where I will review and sign off and
10 then send it back to the director who is procuring the
11 goods or services. Then they can sign the contract,
12 get the vendor to sign the contract, and return it to
13 my office so that we have the complete record, all
14 together.

15 So, we are looking that the complete record
16 would be the people that you have contacted to solicit
17 bids, the need for the goods or services, the selection
18 process, the contract, and what efforts you have made
19 included in there to use the General Services
20 Administration or the Small and Disadvantaged Business
21 so that we have the complete package. And if there
22 is -- all the bids come in along with, of course, the

1 one that is selected so that we have a full package if
2 anybody comes to look at it and say, "Oh, you got three
3 bids," and we have got all the information together.

4 If there is contracting to be done over
5 \$10,500, we have a formal process for those, and that
6 is that we have a written RFP. Again, there is an
7 expression of need that is done. We then -- either the
8 director writes that RFP -- we have given them pro
9 forma information that we require in the RFP. Ron and
10 the OLA group will help them write the RFP so that we
11 make sure that we get everything right. We will then
12 post that.

13 Last one we did was GovBiz we posted the award
14 on. We identify five, six, seven vendors that we send
15 it to, and we ask them to bid on the package, usually
16 giving them a two-week time period, so that we can make
17 sure that we are running -- if we need something and we
18 are looking at a particular time that -- we are not
19 leaving it open-ended, that we can then solicit the
20 bids and get them in and get them reviewed.

21 Again, we ask that there be a matrix involved,
22 where they make the decision that not only the people

1 that are purchasing the services, but those that may be
2 using it, other people in the Corporation who has an
3 eye toward this, so that we have more eyes than just
4 the office that is procuring the goods or services
5 looking at it to make sure we are getting good value
6 for our money.

7 When all of that is done, it again comes back
8 to OLA, where we make sure we do a contract approval
9 form. And I should have mentioned that before. All of
10 this is documented on a contract approval form. It has
11 the originator's name, the services that we are
12 proving, the dollar value, has the areas where you did
13 solicit GSA, Small Business and disadvantaged business,
14 what type of bidding process. And then it has an area
15 for you to write an explanation for making the
16 selection. If that is not enough room, then you put a
17 memo on it.

18 So, all of that information goes to Legal
19 Affairs, who then reviews it to make sure that there is
20 legal sufficiency in the contract. And then it comes
21 to me, once everything is settled there. And if there
22 is discussions beforehand, we are working with the

1 directors, Legal Affairs, and myself, to make sure that
2 when we get to this point, that we are trying to get
3 everything handled up front, so that we don't have a
4 problem.

5 One of the things that was pointed out in our
6 fraud vulnerability study is we have had people saying,
7 "Yes, we need this service for our computer systems for
8 maintenance," but it wasn't documented.

9 In the trainings we have stressed that we want
10 the -- doesn't have to be a long memo, two or three
11 lines. We need maintenance security system,
12 maintenance contractor for our computer systems. And
13 then you go out and you solicit the people who would do
14 that for you, so that we make sure that we are
15 documenting all of our steps, all along, the
16 decision-making documented, and then the process that
17 we use.

18 Any time that there is a contract between,
19 basically, zero to \$10,500, the director can sign that.

20 Anything over 10,500, the President signs off that
21 there is a -- everything has been fulfilled, as far as
22 the requirements of the contract approval form, all the

1 steps have been followed, OLA has signed off, I have
2 signed off, I take it to the President to sign off.
3 The President will sign off, and then we will give it
4 back to the directors.

5 We have had instances where the President
6 signs the contract when it is of a larger dollar
7 amount, but we have also had circumstances where the
8 director are authorized to sign it once the President
9 signs off that the contract is available to move
10 forward.

11 When the invoicing comes in, we have asked
12 that the invoicing come to the comptroller's office,
13 the Office of Financial Administrative Services. That
14 way we can keep track of when the invoices come in. We
15 can create a list, send it -- if there is one that
16 comes in for Legal Affairs, we can send it to Legal
17 Affairs. If we don't get it in a week, we are going to
18 call up and follow up and make sure that we get the
19 invoices back, so that we can get them aid promptly.

20 And any time that there is a check after all
21 the approvals have been processed, any time that there
22 is a check produced over \$7,500, usually the checks

1 come out with two signatures with me and the President,
2 and it is reviewed an accounts payable in my office,
3 the accounting supervisor, and me. But any time that
4 the check is over \$7,500, we also have another set of
5 eyes on it, whether it is the President, Special
6 Assistant to the President, or Ron, as the Vice
7 President for Legal Affairs.

8 So, we are trying in every circumstance to
9 make sure that we have got enough eyes on the
10 situations to make sure that we are getting best value,
11 that we are following all the procedures on this, and
12 making sure that we are following each step as we go.

13 The next major item that we do as far as
14 spending is in travel. And, again, because of the
15 fraud vulnerability study, we put a couple of new
16 wrinkles in the process. When somebody is to travel,
17 there has always been a travel authorization form. If
18 a Board member travels, the corporate secretary signs
19 off. If the President travels, I have been signing
20 off, sometimes Richard will sign off. But we have a
21 travel authorization form. I take that back; I have
22 done all of the President's at this point. We sign off

1 on the travel authorization forms. That way, we know
2 that the ticket that is being purchased through our
3 travel agency is appropriate.

4 We get GSA pricing for hotels, and we follow
5 those. We have a website that we look at. Bernie, who
6 all of you work with, handles that very well. She
7 knows the system in and out. She helps arrange the
8 hotels with the picking -- even when our -- for the
9 board meetings, when our people go out for program
10 performance or on compliance visits, we will contact
11 the grantee and get the area where they want to stay,
12 we will solicit hotels, and then we will call them and
13 tell them we are eligible for GSA pricing, and that is
14 the way that we go about getting our hotels.

15 To pay for that, we have credit cards. Most
16 of you have the Citicorp credit card that we use. And
17 this is a change within the system that we did make.
18 Before, when a Board member come in, we just
19 automatically did credit cards and made them available.

20 When we have a new employee come in, sometimes the
21 director will walk up and say, "This is Ron Flagg.
22 Issue him a credit card."

1 What we have instituted is a credit card
2 authorization form. So, when Ron came in, President
3 signed a credit card authorization and give the dollar
4 amount for the limit that was available, and we then
5 contacted Citibank with the proper applications and got
6 the credit card. Before we were doing that, like I
7 said, with somebody walking up and saying, "We would
8 like to have this." Sometimes we would do it with an
9 email. But we have more formalized it.

10 So now, everybody in the Corporation, even
11 those that have had them for years, we now have gone
12 back and had them fill out the credit card
13 authorization form with the credit limit, so everybody
14 knows their credit limit, everybody knows the advance.

15 You can get cash advances on them. If you have cash
16 expenses, if you don't charge your meals, cab
17 fares -- although now, most cab fares are taking credit
18 card -- but if you need some money for those
19 out-of-pocket expenses, that is available to you.

20 When we get the credit card statement in and
21 the traveler gets a copy, we get a matching copy. The
22 procedure that I use is to go down and review every

1 expense on the credit card. I want to make sure that
2 there is a legitimate reason for the charge. We have a
3 travel card, we have a purchase card, and we have an
4 integrated card, which allows both purchase and travel.

5 So I look at all of those. And there are times when I
6 will look down and have to call an employee about what
7 is this charge for, or what -- and note it on the
8 credit card, as to what the charge is for.

9 It has been a number of years ago, but I did
10 have an employee looking at a credit card, at a bank,
11 and it was the same bank that we had a credit card
12 with. They went out to a movie, paid it with their LSC
13 credit card, realized it that next -- that night. Came
14 in the next morning, "I owe you \$12 for this." Wrote a
15 check, and then, of course, we paid the credit card.
16 Those things happen. We try to watch it very closely.

17 We ask the employees -- they have got a list of do's
18 and don't's that they can use for the card, but
19 sometimes there is mistakes, and we document it, get it
20 reimbursed, and move forward.

21 For events such as this one, for
22 instance -- and any of the OCE and OPP trips -- what we

1 do is we get a copy of the credit card charges, we
2 match it to the expense account, to the travel expense
3 report that has come, to make sure that we account for
4 everything. We have balances that we routinely check:
5 one for the credit card and one for the airline
6 tickets. So we make sure that any charge that is on a
7 credit account is matched to an event and then is
8 basically matched to the event and is used on an
9 expense report, so that we can account for all the
10 charges that are made. In doing so, we keep a running
11 balance of the account.

12 Any time there is an expense report that is
13 over 30 days, we contact the traveler or their
14 director, making them aware that these expense reports
15 are due to be turned in. And if they are not turned in
16 within a particular time, we have a process that we can
17 suspend the card for a time. We have had to do that in
18 the past on a couple of occasions. And it is suspended
19 for either six months or -- in one particular case, a
20 credit card was suspended by a year when we talked with
21 the director and -- that means when that person has to
22 travel on LSC business or purchase anything, they do it

1 with their own credit card and seek reimbursement with
2 us.

3 It makes them more on their toes to get things
4 turned in timely. And it also makes us more studious
5 to following up quickly, making sure that everything is
6 accounted for properly, timely. We wouldn't want an
7 expense to come in seven or eight months later, or we
8 wouldn't want it to go across a fiscal year, if at all
9 possible. It does happen occasionally, but there are
10 few, very few, at this point.

11 So I think, with the internal controls that we
12 have, as far as with the credit card, with the
13 balances, the advances, checking the expense reports,
14 making sure they are taken care of with an event, I
15 think we have pretty good controls in place. And when
16 the fraud vulnerability study was done, the IG
17 did -- the office agreed that we did have those. But
18 the change that we made was to get everybody to
19 document how much their credit card limits were, and
20 make sure that they knew them. Because some people
21 thought that they had \$10,000 limits, and they had
22 \$6,000 limits.

1 \$6,000 is the lowest limit that the card
2 company allows us to put at this point. That is what
3 is recommended by GSA, because the people are
4 traveling. If you travel the first week of the month
5 and the last week of the month, it runs up to that
6 approximate amount, according to the studies they have
7 made, especially when you are traveling a week at a
8 time, so that is what we have used. We keep a running
9 balance of that. I have all the records in my office,
10 so that we can make sure.

11 There is -- occasionally, when you have key
12 employees who are traveling, we can change it in a
13 matter of half-an-hour on the website to increase it
14 for a two-week period or a three-week period, and then
15 it goes back to the lower amount, if we need to, at the
16 end of an expiration time that we put into the system.

17 So, we manage it closely. We want to make
18 sure that we have good financial controls in place. We
19 want to make sure that we are following these to the
20 letter, so that we can protect the resources of the
21 Corporation. That is the basic premise that I had for
22 the financial controls over the cash and so forth.

1 But I did want to mention one additional thing
2 in regards to financial controls, and that is what is
3 going to be happening Tuesday morning at this morning.

4 We have -- most of what I have just talked about is in
5 the administrative manual. Some is in the accounting
6 manual. We revised those as we needed. We have just
7 had a new revision of our accounting manual.

8 But what we are going to do Tuesday morning
9 involves the consolidated operating budget, and that is
10 a key element within the financial oversight that we
11 look to, the budgeting. We begin this year, in July,
12 producing a budget for this year. We provide
13 information as to what we think our appropriation is
14 going to be, we estimate our carryover. My practice
15 has always been to estimate low on carryover, because I
16 would rather come back to the Board and say, "I have an
17 additional \$300,000 that I can add to the budget,"
18 instead of saying, "I need to subtract \$300,000
19 somewhere."

20 CHAIRMAN MADDOX: David, we have got about 35
21 minutes to go. I am just wondering. Is --

22 MR. RICHARDSON: Three minutes.

1 CHAIRMAN MADDUX: Okay.

2 MR. RICHARDSON: Basically, the procedure that
3 we go through is we have produced this budget, it is
4 reviewed by the President and management. It is being
5 presented to the Finance Committee at this meeting, and
6 hopefully we will have a budget put in place for
7 the -- to begin the work of the Corporation for this
8 year, until we get a full appropriation. We don't have
9 a full appropriation. We have funding through January
10 15th at this point, at which time we will either
11 have -- we will have a new budget that we will have to
12 come back to you and present in January.

13 We do monthly reports that -- in my office.
14 We talk to each director about those reports, whether
15 it is spending issues that come up. The reports are
16 reviewed by the President, and then we also give them
17 to the Board. I try to copy the Board on all of the
18 reports. And then, of course, they are addressed to
19 the Finance Committee and then we have a briefing on
20 it.

21 Most of the time we are doing a monthly, but
22 there are occasions when there is sort of nothing going

1 on, or a busy time, we can't get people together unless
2 there is a real crisis, which there has not been for a
3 number of years. We will do the briefings monthly, but
4 if there is occasion to skip a month, it is not a major
5 concern.

6 But we do this so that the Board is fully
7 aware, our management is fully aware of the spending of
8 the Corporation, where they stand on their budget,
9 where their modifications are needed, when there is a
10 circumstance of changing priorities, that we can
11 address those. The President can make changes within
12 the budget up to \$75,000. Anything over that, within
13 our guidelines, has to be presented to the Finance
14 Committee and then either ratified or sent back to us
15 for change. But once the Finance Committee does
16 approve it, then it goes to the Board for approval.

17 So, I think all of those are good controls
18 that we have in place over our finances, and I would be
19 glad to answer any questions you may have at this
20 point.

21 CHAIRMAN MADDIX: Questions from the
22 Committee?

1 MR. SNYDER: David, Paul Snyder. One question
2 for you. Do we have, in a summarized manner, I guess
3 for each of the key processes -- I think you have
4 identified grants, payroll disbursements, contracts,
5 and there could be others -- but for each of those key
6 processes, have we gone through and summarized what we
7 believe to be the critical risk in each of those
8 categories? And then, for each of those critical
9 risks, identified the key internal controls they either
10 monitor or mitigate those risks in a summarized
11 fashion?

12 So I think Jim mentioned when -- at the start,
13 that there is a ongoing management testing of internal
14 controls to make sure they are in place. If there is
15 such a document, obviously that is something that they
16 would look at and say, "Here is the controls everybody
17 is relying on. These are the ones I am testing," so
18 that we have a common understanding of where our key
19 controls are at. Do we have such a document?

20 MR. RICHARDSON: My accounting manual contains
21 most of this. It is about a 70-page document. There
22 is not a single summary one --

1 MR. SNYDER: And is there a summarized -- and
2 somebody can look at it? Because your presentation was
3 very good, I tried to take a lot of notes. But I was
4 just thinking. Have we gone through in a summarized
5 manner in trying to make sure that people, when they
6 test the controls as Jim mentioned, there is that
7 common understanding of what controls we are relying
8 on?

9 MR. RICHARDSON: We have not done it in a --

10 MR. SNYDER: Something that you can consider.

11 MR. RICHARDSON: I am sorry. We have not done
12 it in a summarized manner, as yet. It is something
13 that I am working on, and I hope to finish and have
14 available at a future time.

15 MR. SNYDER: Just one observation. I think
16 that would be real helpful for folks. But, again, I
17 understand you got a lot on your platter.

18 One other clarification I would like to
19 make -- David, I think we are on track with this
20 one -- is WithumSmith+Brown does a substantive audit,
21 as I understand from talking to their partner in the
22 past. So they don't do a lot of testing of controls.

1 And while they go through the audit, they might detect
2 an audit adjustment and then relate it back to
3 controls, they do more testing of transactions rather
4 than testing of controls. Is that correct?

5 MR. RICHARDSON: That is correct, sir. They
6 do some substantive --

7 MR. SNYDER: So I just wanted to go back, as
8 well. We may get some comfort if they don't come up
9 with any major issues. It is really kind of a point in
10 time, and they are not really giving us any assurances
11 that the controls we have in place are adequate or the
12 right controls.

13 MR. RICHARDSON: Yes, sir. When you are
14 talking about an audit, it is their role to have a
15 basic understanding of the internal control, and -- but
16 they don't test each and every one of them in
17 performing the financial audit. That would be a new
18 scope of audit for them.

19 MR. SNYDER: Right, and we haven't engaged
20 them for that. I just wanted to make sure we had
21 clarified that point. Thank you.

22 MR. RICHARDSON: Yes, sir.

1 MR. SANDMAN: Paul? This is Jim. I just
2 wanted to clarify that the management testing of
3 internal controls that I was referring to is something
4 that we plan to do prospectively. It is not something
5 that we have done on a systematic basis up until now.

6 MR. SNYDER: Okay, good. And I would, if you
7 go through -- just with public companies, as they go
8 through the compliance Section 404 controls, et cetera,
9 that is where most companies are moved to have
10 management make the assessment of those controls,
11 report up, and there is no better place than having the
12 management who knows what has changed in the
13 environment to do it. So I think that is a great move,
14 Jim, to do that.

15 CHAIRMAN MADDOX: Julie, did you have a
16 question?

17 MS. REISKIN: Yes. That was really
18 interesting, thank you.

19 What I noticed is that it seems like there is
20 a pyramid. It goes kind of up to the top, but then
21 there is very few people at the top. So do things get
22 bottlenecked and sit on desks, just because there is so

1 few people?

2 And then, what is your procedure that if, God
3 forbid, something happen to you -- I mean whether good
4 or -- like you got hit by a bus or if you went on
5 vacation for two weeks, what is the process to keep
6 things moving if for some reason one of those top
7 people isn't available?

8 MR. RICHARDSON: Yes. In my particular office
9 I have an accounting manager who would step in and
10 review the contract approval forms and sign it and move
11 it forward.

12 When you have directors -- for instance, OPP
13 and OCE, they have special assistants that are assigned
14 to them that can sign expense reports and travel
15 vouchers, also. And, of course, it can go up. It
16 doesn't necessarily have to be Janet or Lora; it could
17 go up to Lynn to sign. But it could also be one of
18 their two --

19 MS. REISKIN: So there is a back-up.

20 MR. RICHARDSON: There is back-ups in
21 circumstances there, yes. And we have not experienced
22 a significant back-up anywhere.

1 CHAIRMAN MADDOX: Thank you, David. Ron, did
2 you have anything to add?

3 MR. FLAGG: I would add one point, which is
4 David talked about the controls and the policies, as
5 they exist today. And Paul made mention of those.
6 And, obviously, it is very important that these be in
7 writing, and they are. But we are continuing -- as has
8 been mentioned a couple times today, we are continuing
9 to look at the policies.

10 And, for example, the first administrative
11 policy that we are revising right now is on the
12 procurement and contracting. So this remains an
13 ongoing, sort of dynamic process.

14 CHAIRMAN MADDOX: Good. Jim?

15 MR. SANDMAN: I just want to add one thing.
16 This idea of management testing of our own internal
17 controls was something that Dutch Merryman mentioned to
18 me. So I want to acknowledge and thank Dutch for his
19 suggestion.

20 CHAIRMAN MADDOX: Okay. Well, thank you all
21 for that informative briefing.

22 CHAIRMAN MADDOX: We are going to move to item

1 number six on our agenda, a briefing about referrals by
2 the Office of Inspector General to the Office of
3 Compliance and Enforcement regarding matters from the
4 annual independent public accountants audit of
5 grantees. It is kind of a mouthful for an agenda item.

6 And we have a panel today of Jeff Schanz, our
7 Inspector General, and he is coming up; Ron (Dutch)
8 Merryman, Assistant IG for Audits; and Lora Rath,
9 Director of Compliance and Enforcement. Welcome to all
10 of you, and I will turn it over to the three of you.

11 MR. MERRYMAN: I will try to make the briefing
12 shorter than the title.

13 (Laughter.)

14 CHAIRMAN MADDOX: Good. We have only got
15 about half-an-hour, and we do have another couple of --

16 MR. MERRYMAN: Are there any questions?

17 (Laughter.)

18 MR. MERRYMAN: The way I read and interpreted
19 the instructions from the Committee last time was to
20 provide information on what we do in the way of looking
21 at the IPA reports, maybe some of the issues that we
22 have been finding, and how do we interact with OCE on

1 some of that information. Also, what was the QCR
2 program, how was it structured, and how were the two
3 different, and what were some of the results of the QCR
4 program. Those are the things I would like to cover
5 today.

6 The IPA review, desk review, and the QCR
7 program, is something we include in each semi-annual
8 now. So there is a section in audit that does cover
9 that, that does give some information each time, so
10 that the number of reports reviewed and type of
11 findings are available.

12 But, basically, the desk review portion and
13 looking at the IPA reports has three primary purposes.

14 The first is to identify for open significant findings
15 to OCE to enter into the follow-up system, and to track
16 them to make sure that corrective action is taken. The
17 second thing is to determine if the report contains all
18 the required information. And the third thing is to
19 identify areas of interest to the OIG to consider in
20 selecting grantees for review. Part of our overall
21 risk assessment is to look at the IPA reports and use
22 information from there to populate one of our risk

1 factors, which is the IPA reports.

2 In identifying significant findings, the IPAs
3 will identify findings in reports. They will judge
4 them to be significant or not significant. What we do
5 is we look at those findings and we look at the
6 management letter, and we make our own judgement as to
7 the significance of the finding, partly because of
8 political sensitivities, to be honest with you. I
9 mean, GAO, in their report on oversight, cited two \$50
10 transactions, not because of the dollar amount, but
11 because they viewed them as being for lobbying types of
12 activities. So we want to make sure that we don't miss
13 those types of things if they might need to be
14 corrected.

15 So, we might find something in a management
16 letter that says, for instance, that maybe one
17 individual who was over income was served, or we didn't
18 know what the income was, and since it wasn't very
19 many, it was just a minor thing they need to address,
20 we might bump that up and say, "We want to forward that
21 over to OCE to take a look at," because even one can be
22 significant, in some cases.

1 But what we do is we look at the findings, see
2 which ones that we consider to be significant, see
3 which ones where management action has been completed
4 or not completed. If it has been completed, we don't
5 refer it, obviously, for follow-up to figure out what
6 management is going to do, it is already documented.
7 Those that we consider significant, we transfer
8 to -- we refer to OCE for follow-up.

9 As far as the -- to determine that the report
10 contains the required information, we actually have a
11 checklist that is put out by the IG community for desk
12 reviews. That is our primary tool. We look at
13 different aspects of the report from the standpoint
14 does it have all the correct statements, does it have
15 all the correct schedules, does it have the information
16 it is supposed to have, according to standards, does it
17 address the areas that they are supposed to address.
18 And then, if we find some issues, we will talk with the
19 IPA, we will send them a letter to get it corrected.

20 We do forward the reports that we receive to
21 OCE, hopefully within a few days of receiving them. We
22 are trying to get it all electronic now, to make it a

1 lot easier. They will find some things that they are
2 concerned with and of interest to them that they may
3 also need to contact the IPA to make sure we understand
4 what is in the report.

5 For the most part, the reports come complete
6 with all the required information. They have the
7 opinion work done, they have the right reports, they
8 have the right schedules. Occasionally, the numbers
9 will get transposed, or one number won't be updated.
10 That might need to be corrected. We might be able to
11 correct that through pen and ink; usually we ask them
12 to send in a new sheet to get the correct information.

13 We have never had a significant -- a real
14 significant -- issue with the format and content of the
15 report, per se, that couldn't be corrected fairly
16 quickly.

17 The third area that we look at is to identify
18 areas or things that would be of interest in looking at
19 a grantee or things that catch our attention. It could
20 be anything that is out of the ordinary, out of place,
21 an account that seems a little strange. It could deal
22 with income. The grantee may receive some income, or

1 significant income, but none of it is allocated to LSC.

2 Not that that is wrong, but we would be interested to
3 know what was going on. So that might pop up on our
4 radar screen, we might highlight that report and use
5 that, then, as a factor in considering when and whether
6 to visit the grantee, along with other factors.

7 It also could be items in the notes that are
8 of interest to us, the notes to the financial
9 statements. It could be something about a restatement,
10 it could be something about a large capital investment
11 or purchase. So there is many things in a report that
12 may trigger interest, and we try to track that and we
13 try to make sure we mark the reports so that we can
14 consider that in our planning processes.

15 Now, I will tell you, 9 times out of
16 10 -- maybe a lot larger than that -- it doesn't turn
17 out, really, to be an issue. But we want to make sure
18 that we find what we can and mind the reports as much
19 as we can.

20 We have done some ratio analysis in the past.

21 It has been very limited in value, from what we have
22 been finding. When I say racial analysis, what I mean

1 by that, we try to look for differences in the balances
2 from year to year, significant changes in certain
3 accounts like expense accounts or travel accounts,
4 items such as that. Some of our other units also look
5 at that, so we share information to the extent that, if
6 we have any issues, we will highlight those and talk to
7 each other.

8 As far as the findings that we refer to
9 OCE -- I am back to the first of the three purposes of
10 reviewing the IPA report. During the last four
11 published semi-annual -- that is where I have this
12 information from -- we looked at a total of about 270
13 reports. There was about 171 total findings of both
14 significant and non-significant manner.

15 And we determined that 81 of those either were
16 not significant, or action had been taken and we did
17 not refer those to OCE for follow-up. Although, OCE
18 has access to that information on all the findings in
19 the report.

20 We did refer 90 findings to LSC management for
21 follow-up, and they fell into about 11 different
22 categories. There is not a real good trend that I can

1 go to. I can tell you that the largest area was
2 something we classify as financial transactions and
3 reporting.

4 And about a third of the findings that we
5 referred was in that broad area. But they went from
6 allocation issues to bank reconciliations to budget to
7 electronic approval of funds to fundraising efforts not
8 being offset, fundraising expenses, the property
9 ledgers not being reconciled, and overdue travel
10 reports. I mean it is just a very, very broad, broad
11 area of things.

12 In some of the others that we found, where
13 there is missing documentation, for instance, sometimes
14 they are missing the citizenship attestation or
15 retainer for extended services, or it is not documented
16 according to their processes for serving someone above
17 125 percent. Those will appear from time to time.

18 So, of that 90, we divided it into 11
19 different categories, and we report under these
20 categories each time. Sometimes there is not a
21 physical inventory conducted for a while. There has
22 been some issues with backups being made, but the

1 backup for data is stored on-site, rather than
2 off-site. So if you lose the building, you lose the
3 back-up, too. It sort of defeats the purpose.

4 Sometimes it is dealing with client trust
5 funds. There was one finding that dealt with the
6 processes and the accountability needing to be
7 strengthened. That could be a lot of -- that could
8 mean a lot of different things, but that was one of the
9 findings. So it is a wide variety of findings that we
10 have.

11 Again, sometimes that is not 90 reports that
12 finding; sometimes there is multiple findings.
13 Sometimes, if there is a grantee that is having a
14 problem, there will be three or four findings in a
15 report at one time. So, that is generally the IPA
16 process.

17 The QCR process is something we instituted
18 -- this is the third year of it, where we have started
19 a process of trying to get out to every IPA who is
20 doing audits for LSC grantees. And the reason for that
21 is that that is where we are going to find out if there
22 is problems with the audit. That is where we get into

1 the work papers. That is where we will see what is
2 going on.

3 So, we set a four-year cycle for this first
4 cycle to test this to see -- number one, to see if we
5 think it is profitable or valuable, or we are getting
6 things, or -- and also to see if this is what we want
7 to do. Is there a better way of doing it?

8 So, we are in the third year. And, basically,
9 what we do is we select 35 grantee IPAs to visit. We
10 don't visit the grantee. We have got a contractor who
11 does this for us. We had the initial year plus three
12 option years. Like I say, we are in the third year.

13 And what we do is we take a look at the IPAs
14 who are doing work for us. We look at dates since
15 anybody had reviewed their work on site, if ever. We
16 look at the experience of the IPA, any known problems,
17 either from the desk reviews or other issues, and any
18 information from investigations or OIG hotline or other
19 audits, and we come up with a list of 35. And we refer
20 them over to the contractor.

21 We provide them information. We provide them
22 the information from our desk reviews and any other

1 information that we have that would be beneficial for
2 them understanding what the audit should be, or how the
3 audit should be structured. And they essentially go
4 out, schedule a two or three-day visit with the
5 individual, and really look at the work papers.

6 Each year we have the contractor provide us a
7 summary of findings. That is part of the contractor
8 requirement. And we take that information and we put
9 it into a memo. And the first year and second
10 year -- well, every year we put it into the audit
11 information section on our website for auditors to look
12 at, summarizing some of the things that they find.

13 For the last two years we looked at 71
14 different IPAs. The audit work met standard,
15 basically, for 61 -- I am sorry, 64 -- 64. That is
16 broken down into three different categories. One of
17 them is 34 of them there were some deficiencies that
18 required them to go back and get additional
19 documentation, or provide additional documentation to
20 us before we would accept the audit. There were 27 of
21 them that had some minor deficiencies and could be
22 corrected in future audits. We didn't consider them

1 significant enough to send them back to go get
2 documentation. And then three of them had no
3 deficiencies.

4 There were seven reports or seven IPAs where
5 the report was classified as not meeting standards. And
6 what we do with those is to have a lengthy discussion
7 with our contractor to make sure we fully understand
8 everything that the contractor has found, and also to
9 have a discussion on corrective action, what would be
10 necessary in order for that audit to meet standards.
11 Can it meet standards, ever, or does it have to be
12 completely redone?

13 In only one case, so far, did we get to the
14 point where it was just no way that we felt to salvage
15 the audit, and we rejected the audit report. Under the
16 regulations, Regulation 1641, there is a process for
17 the debarring and suspending or removing auditors. And
18 we referred that to our legal staff, who are the
19 individuals in charge of those efforts, to go through a
20 proceeding. And that one is under process right now of
21 being looked at whether to debar the individual from
22 doing work for LSC.

1 Now, some of the things that the QCRs are
2 finding deal a lot with documentation, a lot in
3 documenting the work that they do, for instance, on
4 interviews. It is very important, in doing the
5 compliance supplement, whether or not we really contact
6 the people we need to. We do want a minimum number of
7 five people contacted, or five percent of the staff,
8 basically -- I think it is five percent. But we do
9 want certain types of information that we feel they
10 need to ask.

11 If you are looking at a work paper and it
12 says, "Contacted staff and everything is fine," you
13 don't know what the questions are, it is not documented
14 in enough detail.

15 Sometimes we have problems with the case
16 sampling. We like to get different types of
17 characteristics or attributes on the cases, some that
18 are open during the year, some that are closed during
19 the year, some that were open in the previous year, or
20 open and closed in the same year. We try to get a wide
21 variety, and sometimes that is not done.

22 Other issues dealing with the things that are

1 found might deal with property records not looked at
2 completely. It could be that planning for the audit
3 wasn't done properly. In one case, one of the audits
4 that we actually said did not meet standard was a new
5 auditor, was not aware of a very significant OIG audit
6 report that was issued, and didn't consider that in the
7 factors in planning the audit and the testing, and had
8 to go back and do additional work.

9 But we also, like I said, publish these on our
10 website, so that the summaries are on the website. And
11 there is two of them posted on the website under the
12 "Audit Resources" area. And we do follow up with the
13 IPAs for those that we have requested documentation
14 from, or additional documentation, and we do receive
15 additional documentation, and we evaluate that
16 documentation. We have had no major issues in working
17 with the IPAs and getting that additional
18 documentation.

19 Now, we do try to look at the totality of the
20 situation. I mean there are some things we feel that
21 you must go back and look at, and we tell them that.
22 And we feel there are some things that, if they are

1 doing the audit next time, they got a contract to do
2 the audit next time, then we want to see it done.

3 So, those are the two general programs, and
4 that is what we do with them. The difference,
5 basically, is one looks at the report, and then one
6 looks at the backup for the report, to make sure that
7 the report meets standards. We believe that, by doing
8 that, we can rely pretty much on what the auditors have
9 in the report, that it was done correctly, that the
10 information -- they are identifying issues, and will
11 keep working to improve the program to make it
12 stronger, and the support for the findings and the work
13 stronger.

14 Each year -- and we will do it again this
15 year -- we sit down and I discuss with Jeff the
16 program, whether we should go for the fourth year or
17 not. And we will do that at the end of this year,
18 again. I think we are going to start seeing the better
19 benefits coming out these two years, these coming
20 years. We have anecdotally noticed an increase in
21 people calling us, our hotline, our auditor hotline,
22 for questions. And the staff does spend time talking

1 to the IPAs to make sure they fully understand what we
2 are looking for, and what the responsibilities are.

3 That is what I got. Questions?

4 CHAIRMAN MADDOX: Questions from the
5 Committee?

6 MR. SNYDER: Good report. Thanks, Dutch.

7 MR. MERRYMAN: Thank you.

8 MS. VALENCIA-WEBER: You mentioned that when
9 you do interviews with staff, about five percent of
10 them, and that if staff say everything is fine, that is
11 not really sufficient information. I am assuming you
12 have a schedule or a set of questions you ask those
13 staff.

14 MR. MERRYMAN: Well, the auditor will have a
15 set in order to meet the objective for the particular
16 area.

17 Like, for instance, when you look at an
18 operation and you see thousands of cases, we do not do
19 thousands of testing of cases to see what is there.
20 So, sometimes, the only thing you can rely upon is what
21 people will tell you, if you ask them directly. For
22 instance, "Is there any class action cases going on

1 right now, that you are aware of?" They will answer
2 you honestly. But if you don't ask the question, they
3 won't necessarily volunteer that answer if it is
4 happening.

5 MS. VALENCIA-WEBER: Right.

6 MR. MERRYMAN: So, what we like to see is what
7 are the questions that you are asking and getting
8 answers to. Because, without that, without certain
9 attributes listed down of what you have really looked
10 at, there is really no assurance you remember to do it.

11 You might have intended to do it, you might have even
12 done it. But without it being documented in some
13 manner, we just feel better to see some documentation
14 as to the list of the questions that were asked to
15 people.

16 Because we ask them to ask the executive
17 director, talk to the CFO, talk to attorneys, talk to
18 intake people. We try to get them to talk to people in
19 branch offices. We want a variety of information. And
20 so we just think it is necessary, in order to reach the
21 conclusion there is nothing there, that we know what
22 was asked, or what was supposed to be asked.

1 CHAIRMAN MADDOX: Okay. Well, thank you.

2 Lora, do you have anything to add to this?

3 MS. RATH: Not particularly. I think you
4 remember back in April I gave a pretty broad overview
5 of the different things that OCE does, and I went
6 through the A-50 process. I can redo that, but I also
7 know we are running out of time. So if you guys don't
8 have any questions for me about it, I am happy not
9 saying anything else.

10 CHAIRMAN MADDOX: I don't think there are any
11 questions. Thank you.

12 Dutch, you said --

13 MR. HOFFMAN: Vic, this is David. I have some
14 questions for Dutch.

15 CHAIRMAN MADDOX: Go ahead, go ahead.

16 MR. HOFFMAN: And I know we have been going
17 about an hour and 20 minutes already. I wanted to ask
18 you questions, because I think this kind of gets to
19 some of the key internal control protections regarding
20 grantee oversight that we have been talking about the
21 last few meetings. But how much longer do you want to
22 go here, or how long do we have until the meeting ends?

1 CHAIRMAN MADDUX: We have got about 15
2 minutes, David, or less.

3 MR. HOFFMAN: All right. Well, let me just
4 try to jump in on a couple of things.

5 So, Dutch, thank you. I also thought that was
6 a very helpful summary. And it does sound to me like
7 the QCR system is a valuable one. Just a couple
8 factual questions, first. Who is the contractor that
9 you guys use?

10 MR. MERRYMAN: McBride, out of St. Louis,
11 McBride and Company.

12 MR. HOFFMAN: And you said you had started
13 with a one-year contract and with three option years.
14 What is the approximate annual amount that we pay them
15 to do it?

16 MR. MERRYMAN: We pay them about -- the first
17 year is \$5,000 per visit, plus an escalator for each
18 year of, I think, three percent, plus travel. So it
19 has been running into the \$200,000, \$220,000 range for
20 each year, roughly.

21 MR. HOFFMAN: Okay. And you said that there
22 were 35 IPAs at a time that they were doing. I take it

1 that is semi-annual, because then you said there were
2 about 70 total in a year. Approximately how many IPAs
3 are doing work auditing grantee statements?

4 MR. MERRYMAN: Well, the quick number is 135,
5 but that is the number of recipients we have that
6 absolutely must go through an audit each year,
7 according to the appropriations act. But there are
8 changes each year. So we wanted to build in a little
9 bit of excess to try to pick up people who we might
10 have visited the IPA for a certain grantee, but in the
11 three years or four years, then they might have hired a
12 different one and we want a little wiggle room to go
13 back before we have to enter into a whole new contract.

14 MR. HOFFMAN: And you said you are doing about
15 35 or about 70 a year?

16 MR. MERRYMAN: No, about 35 a year. This is
17 the -- the first two years we actually did 71, 36, and
18 35. This year we are doing 35. And then next year we
19 are going to look at what we have left.

20 The other thing is we structured it -- because
21 we are trying to do an evaluation each year about the
22 benefit of it, we actually structured it to have the

1 overseas locations, or out of the continental United
2 States locations pushed to the last year, in case we
3 didn't proceed, and would try to save some costs that
4 way.

5 MR. HOFFMAN: Got it. So, basically, we can
6 expect an IPA to go through this review about once
7 every third year, given this level of resources with
8 the contractor?

9 MR. MERRYMAN: Once every four years is what
10 we started with. Now, we are not set on that being
11 what it is going to be finally, because we have got to
12 do an overall program assessment. We may find out that
13 we think it is still valuable to do it this way, but
14 maybe we want to stretch the time frame.

15 MR. HOFFMAN: Okay. And is one of the things
16 that they test for independence from the grantee?
17 Because I know that, for instance, my comfort level
18 about the reliability of an IPA audit of a grantee, one
19 of the things that I would want to know is are they
20 totally independent of the grantee, which would require
21 a little bit of due diligence to know who is who and
22 what is their experience. Is the independence point

1 one of the things that the contractor is examining?

2 MR. MERRYMAN: Absolutely. It is a very
3 important general standard for any work done under
4 government auditing standards, or AICPA standards. So
5 they do look for the appropriate documentation and the
6 appropriate requirements for assessing the impact that
7 any relationship would have on the independence of the
8 people doing the work.

9 MR. HOFFMAN: Okay. And last question about
10 the QCR thing is, so you have got 34, about half of the
11 71 that had some deficiencies that were significant
12 enough that the audit report could not be accepted, at
13 least for the time being. And then, worse than that,
14 you had 7, or about 10 percent, who were not -- simply
15 not meeting the standards.

16 And I heard what you said, that the next step
17 would be to figure out do we just need this audit to be
18 completely redone or not. My question really is about
19 your comfort level, or our comfort level, going forward
20 with those seven as authorized IPAs or the grantees.

21 Is there some process for -- because I
22 would -- to me, that is a big question mark about

1 whether we should allow those seven to continue serving
2 as IPAs for the grantee if there were such significant
3 problems that the contractor found. How do you view
4 that, and what is the assessment process of this to
5 make sure that the IPAs that actually are doing the
6 work have gotten through the QCR process and are deemed
7 actually qualified?

8 MR. MERRYMAN: Well, what we do is, initially,
9 when we get a report like that, we have a conference
10 with the contractor and go over the details of what was
11 found, how significant were the things, and also to get
12 an impression or an opinion from the contractor, since
13 they have the firsthand knowledge, on what would be
14 necessary, if anything, in order to bring this audit up
15 to standards.

16 Based on that discussion, then we formulate
17 specific actions that we believe need to be done in
18 order to do this, and provide the information to the
19 IPA exactly what we want done and what needs to be
20 done. Through this process, in discussing these with
21 the contractor, there was one case where it just could
22 not be salvaged. There was nothing, short of doing the

1 audit completely over. And what we did at that point
2 in time is we called in for some specific
3 documentation, took a look at it. We agreed, and
4 referred it to the legal department to go through the
5 1641 process for debarment.

6 We get the information in, and we do another
7 evaluation of the information, matching it to what was
8 necessary to be done. Most of the things are not
9 capability issues. Most of the things get to be
10 that -- from the standpoint of do we want the
11 individual or not, well, I guess you could always make
12 a case that if someone does a pretty terrible
13 job -- which we do let the executive director know, the
14 executive director is well aware of the quality of work
15 they are getting, we do send them a copy of the QCR
16 report and everything else. But you could make a case
17 to go through the debarment process and have them
18 removed, suspended, or debarred for all of them.

19 We have not done that at this time, but we do
20 talk about it. It is a -- there are several issues
21 with some of those types of things that --

22 MR. HOFFMAN: Yes, let me -- in the interest

1 of time, let me just stop you there. I think that -- I
2 hear what you are saying, and that is obviously going
3 to be case-specific and situation-specific, about
4 whether debarment of the IPA is appropriate, or -- and
5 only the people on the ground, including you, will have
6 a sense of that.

7 In the interest of time, I just want to make a
8 couple of broader comments here, that I thought this
9 briefing and the prior briefings have been very good.
10 Part of, I think, what we have been trying to do, as a
11 committee, is get an organized sense of what the IG's
12 office does and what OCE does with regard to the issue
13 of oversight of grantee funds, since that is,
14 obviously, the vast majority of the LSC funds, and the
15 problems of abuse in that area were the things that led
16 to the creation of the Fiscal Oversight Task Force.

17 And so, I would say, in summary, the past few
18 meetings have been very educational. I,
19 personally -- what the IG does regarding grantee
20 oversight in four areas. One is your own audits, which
21 may result in findings referred to OCE. Second are the
22 IPA audits, and you just described your oversight of

1 that and how those IPA audits may lead to findings that
2 get sent to OCE. Third is your quality review process
3 for the IPAs themselves that may result in your
4 identifying some IPAs that should no longer do work on
5 these. And fourth are your investigations.

6 And then, we have OCE that either -- in my
7 mind, I think of them as doing really two things on
8 this issue. Number one, taking the various findings
9 that they get from the IG and doing follow-up work, or,
10 number two, doing their own program review.

11 And one of the things that I would like to
12 suggest is that I think that as we have -- I am not
13 sure we have gotten to the end, but I think we made
14 tremendous progress in getting educated about these
15 various things that the IG's office knows that you do.

16 I think that we, going forward, need to start
17 receiving -- I would suggest that we should be
18 receiving from both the IG and the OCE -- and they
19 could coordinate, if they wanted -- some sort of
20 regular reports, presumably in advance of our Committee
21 meeting -- that describe the specifics, what they have
22 done, and what the status is of various open issues in

1 each of these areas. And that will allow us to really
2 focus our discussion on is the process continuing to
3 work on an ongoing basis.

4 Because as we hear these very helpful general
5 descriptions of the processes, those are very important
6 so that we can get educated about them. But for us to,
7 as an Audit Committee, do our job on an ongoing basis,
8 I think within this organization that I just laid out,
9 we need to be getting sort of regular charts or reports
10 from the IG's office so that we can ask questions and
11 ask, "Okay, I see you have seven IPAs," for instance,
12 "that meet the test. Explain why you think six of them
13 are still fine. We see the information" -- or, "We see
14 that you have done three audits in the last quarter
15 with very few questioned costs, but a few findings
16 given to OCE. Can you explain the status of those,"
17 and so on.

18 I think that if that -- and the last one I
19 will make about this is I am going to go back to the
20 related point that the CBO made -- maybe it was the CBO
21 made -- the CBO made in their -- I may be getting my
22 independent governmental offices mixed up here -- but

1 that they made in one of their reports several years
2 ago, that in assessing what grantees are potentially at
3 risk on these issues, that there is three or four or
4 five of these different integrity checks that you all
5 do that we have been looking at.

6 But I haven't seen anything that combines the
7 information and says, "Yes, grantee number one, we have
8 got an IPA that doesn't meet the test, we have got
9 three findings from our own audit, we have got an OCE
10 program review where there has been problems." That
11 grantee is something that we need to maybe spend a
12 little more time on. Now -- or at least be focusing on
13 a little bit more. And that conclusion is not going to
14 be true with regard to the vast majority of grantees.
15 And I just haven't seen any process that collects all
16 of these six different types of integrity checks and
17 puts them together to allow the committees of the Board
18 to see where there is a problem.

19 And I think -- it feels to me like we are at
20 that pivot point, where we could start receiving
21 information from the IG's office that is organized in
22 the way I have laid out, that is more specific, and

1 that would allow us, as a committee -- and presumably
2 other committees -- to do their job as well as
3 possible.

4 MR. FLAGG: I recognize it is late in the day,
5 but there was one comment made that I think requires
6 some clarification. From OLA's standpoint, we think it
7 would be not appropriate and not a good idea to be
8 discussing open investigations, open compliance
9 proceedings that are in OCE in this Committee. I think
10 everything that was just said can be done with respect
11 to recently closed matters. But to have the Committee
12 actively debating with management or the IG about what
13 should be done in an open enforcement proceeding or
14 compliance proceeding is, I believe, inadvisable.

15 So, again, I think, for the purpose of the
16 oversight that was just described, getting a report on
17 the last three years of activity with respect to closed
18 matters, that shouldn't be a problem. Those matters
19 are public. But to have an ongoing debate in this
20 Committee about open matters I think is inadvisable.

21 MR. HOFFMAN: Well, I agree with that, and I
22 don't think that the process that I am describing would

1 result in such a debate or any discussion on the merits
2 of open issues. I agree with you. If an issue is
3 open, sitting with management, then it is really up to
4 management to decide what it thinks it should do. But
5 it would be relevant to hear, "Okay, well, we
6 have -- out of all the findings that have been referred
7 from IG to OCE, there are 20 of them, and 19 of them
8 have been open for 2 years." Right? I think numbers
9 and duration would be relevant information for the
10 Committee to hear.

11 And I think some reports that provide that
12 information, in addition to -- I agree with
13 you -- allowing a look back on whether these processes
14 are working by getting some specifics about them would
15 be useful. And I think it would be -- I have been on
16 the Audit Committee for about two years now. And,
17 frankly, we have never, not once, received any sort of
18 regular information at that level from the IG's office.

19 So I found it very difficult to assess whether the
20 processes that exist are working. And I think that is
21 a central core function of what we are supposed to do,
22 as a Committee.

1 So, I don't know exactly what form those
2 regular reports would take, and I am sure it would be
3 an organic process that would develop over time. But I
4 think that if we don't do that, now that we have sort
5 of gotten educated about what the IG and OCE processes
6 are, I don't -- I think it would be difficult for us to
7 make that assessment, going forward.

8 CHAIRMAN MADDUX: Thank you, David. I will
9 undertake to talk with the folks who need to be
10 involved to see what sort of form those reports might
11 take and how we might implement them, so that we can
12 kind of move that process forward, consistent with our
13 general counsel's concerns, and I think the concerns of
14 management, as well. So, maybe we can have that in
15 place for our next quarterly meeting.

16 Are there any other comments or questions?

17 (No response.)

18 CHAIRMAN MADDUX: I am not sure what our
19 process is here. We have got one more briefing on our
20 agenda.

21 Dutch, go ahead.

22 MR. MERRYMAN: It is really not a briefing, it

1 is more just to say we sent this out. If you had
2 questions on it, we didn't give you time to ask us
3 questions, because we sent it to the Audit Committee
4 via email. So if you had any questions, the only
5 thing -- that was the only reason. It was not to brief
6 it. It is not original work, it is just a collection
7 of the various rules and regulations and publications
8 that cover it so you had some background information.

9 So that is the sum extent of the briefing.

10 CHAIRMAN MADDOX: Well, I thought the
11 materials that you sent were helpful. I don't know,
12 David or Paul, if you had a chance to look at them, if
13 they raised any questions in your mind. It is --

14 MR. SNYDER: No, I think it did help, Dutch,
15 from the standpoint of clarifying that in questioning
16 costs -- can be unsubstantiated costs, which can later
17 be cleared, et cetera. So it was helpful to understand
18 the definitions, and also see the history of these
19 things that had been reported and cleared.

20 CHAIRMAN MADDOX: Okay.

21 MR. MERRYMAN: Thank you.

22 CHAIRMAN MADDOX: Thank you, Dutch. It was

1 very helpful.

2 CHAIRMAN MADDOX: Item number nine is public
3 comment. Is there any comment from members of the
4 public?

5 (No response.)

6 CHAIRMAN MADDOX: Did I miss something? We
7 have a 403(b) performance plan memo that has been
8 submitted to us. We don't have any agenda items. The
9 report is generally favorable, again, the plan -- fund
10 has been doing fine. So I think that report will just
11 stand as a part of the record.

12 No public comment, I see.

13 CHAIRMAN MADDOX: Is there any other business
14 that we need to act on?

15 (No response.)

16 M O T I O N

17 CHAIRMAN MADDOX: If not, is there a motion to
18 adjourn?

19 MS. VALENCIA-WEBER: Move.

20 CHAIRMAN MADDOX: Gloria. Second?

21 MR. KORRELL: Second.

22 CHAIRMAN MADDOX: Harry. All in favor?

1 (Chorus of ayes.)

2 CHAIRMAN MADDIX: Thank you, Paul and David,
3 very much for joining us and taking your Sunday
4 afternoon to be with us. And I thank everyone else.

5 (Whereupon, at 6:22 p.m., the Audit Committee
6 was adjourned.)

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