Office of Inspector General
Legal Services Corporation

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MEMORANDUM

TO: Board of Directors
Legal Services Corporation

FROM: Jeffrey E. Schanz
Inspector General

SUBJECT: Transmittal of FY 2010 Financial Statement Audit Report

DATE: January 27, 2011

The Office of Inspector General (OIG) contracted with the independent certified public accounting firm of Thompson, Cobb, Bazilio & Associates, PC (TCBA) to audit the financial statements of the Legal Services Corporation (LSC) as of September 30, 2010 and 2009. The audit was required to be conducted in accordance with auditing standards generally accepted in the United States of America, as well as the standards applicable to financial audits contained in the *Government Auditing Standards,* issued by the Comptroller General of the United States.

The Independent Auditor's Reports by TCBA on LSC's financial statements and Internal Control Over Financial Reporting and On Compliance and Other Matters were dated January 7, 2011. The OIG received the final reports from the Independent Auditor on January 25, 2011.

The Independent Auditor's Report by TCBA stated that LSC's financial statements present fairly, in all material respects, the financial position of LSC as of September 30, 2010 and 2009, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

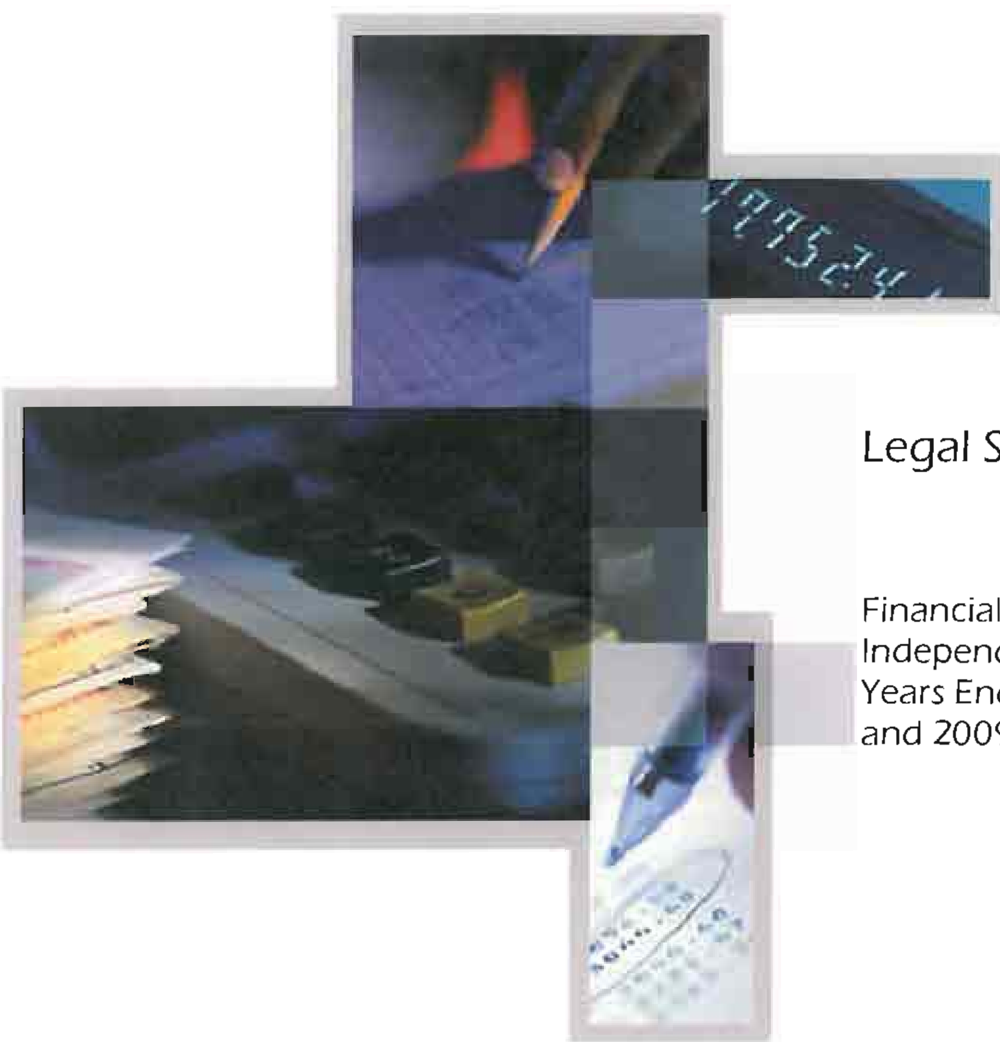
The Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters identified no material weaknesses in internal control and no reportable noncompliance with laws and regulations.

OIG reviewed the audit reports from TCBA and related audit documentation and inquired of their representatives. OIG's review disclosed no instances in which TCBA did not comply, in all material respects, with U.S. generally accepted government auditing standards. Our review, as differentiated from an audit in accordance with generally accepted government auditing standards, was not intended to enable us to express, and we do not express, opinions on LSC's financial statements, conclusions about compliance with applicable laws and regulations, or the effectiveness of internal controls. TCBA is responsible for the attached auditor's reports, dated January 7, 2011, along with the conclusions expressed in the reports.

As part of the audit, the OIG is transmitting two additional reports prepared by the Independent Auditor. These reports are entitled "Report of Deficiencies in Internal Control Over Financial Reporting and Other Matters" and the "Report to the Audit Committee of the Board of Directors and the Office of Inspector General."

Attachments

cc: Victor Fortuno
President



Legal Services Corporation

Financial Statements and Independent Auditor's Report Years Ended September 30, 2010 and 2009

TCBA

THOMPSON, COBB, BAZILIO & ASSOCIATES, PC

Certified Public Accountants & Management, Systems and Financial Consultants

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LEGAL SERVICES CORPORATION
FINANCIAL STATEMENTS AND INDEPENDENT AUDITOR'S REPORT
FOR THE YEARS ENDED SEPTEMBER 30, 2010 AND 2009

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INDEPENDENT AUDITOR'S REPORT

To The Inspector General and the Board of Directors
Legal Services Corporation
Washington, DC

We have audited the accompanying statements of financial position of the Legal Services Corporation ("LSC") as of September 30, 2010 and 2009, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of LSC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of LSC as of September 30, 2010 and 2009, and the results of its activities and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The Management's Discussion and Analysis on pages 17 to 31 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 7, 2011 on our consideration of LSC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of the audit.

Washington, DC Thompson, Cobb, Bazilio & Associates, PC
January 7, 2011

LEGAL SERVICES CORPORATION
STATEMENTS OF FINANCIAL POSITION
SEPTEMBER 30, 2010 AND 2009

	2010	2009
ASSETS		
Cash and cash equivalents	$ 83,596,411	$ 77,940,065
Accounts receivable	479,860	625,342
Prepaid expenses and deposits	380,544	178,663
Fixed assets, net	391,997	395,244
Total assets	$ 84,848,812	$ 79,139,314
LIABILITIES		
Grants and contracts payable	$ 69,431,311	$ 68,335,697
Accounts payable	358,309	302,383
Accrued vacation and other liabilities	1,011,649	1,236,290
Deferred revenue	6,418,891	2,800,129
Total liabilities	77,220,160	72,674,499
NET ASSETS		
Unrestricted net assets:		
Designated	553,445	835,863
Undesignated	6,683,210	5,233,709
Net investment in fixed assets	391,997	395,243
Total unrestricted net assets	7,628,652	6,464,815
Total liabilities and unrestricted net assets	$ 84,848,812	$ 79,139,314

The accompanying notes are an integral part of these financials statements.

LEGAL SERVICES CORPORATION
STATEMENTS OF ACTIVITIES
YEARS ENDED SEPTEMBER 30, 2010 AND 2009

	2010	2009
SUPPORT AND REVENUE		
Federal appropriations	$ 420,000,000	$ 390,000,000
Grant revenue	1,820,290	2,034,086
Interest	6,305	39,379
Other income	10,802	6,598
Change in deferred revenue	(3,619,052)	(1,370,641)
Total support and revenue	418,218,345	390,709,422
EXPENSES		
Program activities:		
Grants, contracts and reimbursable expenses	396,661,702	371,257,115
Supporting activities:		
Management and grants oversight	16,125,945	13,845,616
Office of Inspector General	3,739,699	3,270,879
Herbert S. Garten Loan Repayment Assistance Program	527,162	279,400
Total supporting activities	20,392,806	17,395,895
Total expenses	417,054,508	388,653,010
Change in net assets	1,163,837	2,056,412
Unrestricted net assets, beginning of year	6,464,815	4,408,403
Unrestricted net assets, end of year	$ 7,628,652	$ 6,464,815

The accompanying notes are an integral part of these financials statements.

LEGAL SERVICES CORPORATION
STATEMENTS OF CASH FLOWS
YEARS ENDED SEPTEMBER 30, 2010 AND 2009

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	$ 1,163,837	$ 2,056,412
Adjustment to reconcile change in net assets to net cash and cash equivalents provided by operating activities:		
Depreciation and amortization	312,261	215,810
Loss on disposal of assets	103	583
Decrease (increase) in accounts receivable	47,129	(31,106)
Decrease (increase) in LRAP receivable	98,354	(249,480)
(Increase) decrease in prepaid expenses and deposits	(201,882)	53,560
Increase in grants and contracts payable	1,095,614	6,822,430
Increase in accounts payable	55,926	76,049
(Decrease) increase in accrued vacation and other liabilities	(224,641)	270,493
Increase in deferred revenue	3,618,762	1,366,555
Net cash and cash equivalents provided by operating activities	5,965,463	10,581,306
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of fixed assets	(309,117)	(93,347)
Net cash and cash equivalents used in investing activities	(309,117)	(93,347)
Net increase in cash and cash equivalents	5,656,346	10,487,959
Cash and cash equivalents, beginning of year	77,940,065	67,452,106
Cash and cash equivalents, end of year	$ 83,596,411	$ 77,940,065

The accompanying notes are an integral part of these financials statements.

LEGAL SERVICES CORPORATION
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 2010 AND 2009

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity
Legal Services Corporation ("LSC") is a private non-membership District of Columbia nonprofit corporation, established by Congress in the Legal Services Corporation Act of 1974, Public Law 93-355, and amended in 1977 by Public Law 95-222. The purpose of LSC is to provide financial support to independent organizations that directly provide legal assistance in non-criminal proceedings or matters to persons financially unable to afford such counsel.

Basis of Accounting
LSC's financial statements are prepared on the accrual basis of accounting. Accordingly, revenue is recognized when earned, and expenses are recorded when incurred in accordance with accounting principles generally accepted in the United States of America.

The federal appropriations include amounts received and expended in furtherance of LSC's objectives.

LSC follows accounting standards established by the Financial Accounting Standards Board (FASB) which is the source of generally accepted accounting principles (GAAP) for not-for-profit entities. The financial statement presentation follows the recommendations of the FASB Accounting Standards Codification (ASC) 958, *Not-for-Profit Entities*. Under FASB ASC 958, LSC is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted, and permanently restricted. LSC does not have temporarily or permanently net assets.

Estimates
The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results may differ from those estimates.

Cash and Cash Equivalents
LSC considers all money market funds and instruments with a maturity date of less than 90 days to be cash equivalents. LSC's cash accounts are subject to Federal Deposit Insurance Corporation (FDIC) limits. The FDIC temporarily increased the maximum limit from $100,000 to $250,000 through December 31, 2013. LSC has established target balances above $250,000 and transfers the amounts on a daily basis into government backed securities accounts under a sweep arrangement.

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Support and Revenue
The federal appropriations are reported as support and revenue in the period the public law makes them available. The appropriation remains available until expended. Unexpended grant funds are shown as deferred revenue and adjustments are made to the account Change in Deferred Revenue to recognize the annual adjustment.

Grantee Receivables and Grant Refunds
Grantees who have not complied with the requirements of the Legal Services Corporation Act of 1974 and implementing regulations may be subject to actions that result in a recovery of grant funds. Sources of grant refunds may include recoveries of disallowed costs, excess fund balances, unexpended funds on Private Attorney Involvement programs and sanctions imposed by LSC for failure to comply with other regulatory requirements, as well as other types of recoveries.

Grants and Contracts to Recipients
Liabilities, expenses and revenues related to grant and contract awards are recognized when the awarding document is fully executed. Grant awards are made to recipients on a calendar year basis from appropriations received by LSC.

Property and Equipment
Property and equipment are stated at cost and depreciated using the straight-line method over the estimated useful lives of the assets of five and ten years.

Income Taxes
LSC is exempt from federal income tax under section 501 (c)(3) of the Internal Revenue Code and the applicable income tax regulations of the District of Columbia, except for unrelated business income.

Classification of Net Assets
Net assets related to Federal appropriations have been reported as either designated or undesignated. Designated net assets represent amounts that have been earmarked by the Board of Directors for continuing programs and administrative activities. Undesignated net assets represent appropriated federal carryover and other operating excess, which are available for future use at the discretion of the Board of Directors. Net assets invested in fixed assets represent investments in property, equipment and computer software, net of accumulated depreciation and amortization.

Concentration of Revenue
LSC receives substantially all of its revenue from direct federal government appropriations.

NOTE 2 CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of cash on deposit at financial institutions and undisbursed appropriations, which constitute spending authority remaining available in LSC's account held by the U.S. Treasury. Cash and cash equivalents as of September 30, 2010 and 2009 consisted of the following:

	2010	2009
Cash in U.S. Treasury	$ 46,139,618	$ 41,663,198
Cash in financial institution	37,454,793	36,274,867
Petty cash	2,000	2,000
Total cash and cash equivalents	$ 83,596,411	$ 77,940,065

NOTE 3 FIXED ASSETS

Fixed assets as of September 30, 2010 and 2009 consisted of the following:

	2010	2009
Furniture and equipment	$ 1,939,454	$ 1,824,982
Software	406,050	341,201
Leasehold improvements	351,698	321,687
	2,697,202	2,487,870
Less: accumulated depreciation and amortization	(2,305,205)	(2,092,626)
Total fixed assets, net	$ 391,997	$ 395,244

NOTE 4 GRANT REVENUE

LSC was awarded a grant from the U.S. Court of Veterans Appeals for the purpose of furnishing legal assistance to veterans in non-criminal proceedings.

Additionally, LSC was awarded a grant from the State Justice Institute, a nonprofit organization established by federal law, for the purpose of expanding the number of LSC technology initiative grants.

NOTE 4 GRANT REVENUE (Continued)

Grant revenue for the years ended September 30, 2010 and 2009 consisted of the following:

	2010	2009
U.S. Court of Veterans Appeals grant	$ 1,805,000	$ 1,700,000
Veterans reimbursable expenses	15,290	4,086
State Justice Institute	-	330,000
Total grant revenue	$ 1,820,290	$ 2,034,086

NOTE 5 GRANT AND CONTRACT EXPENSES

Grant and contract expenses for the years ended September 30, 2010 and 2009 were as follows:

	2010	2009
Basic Field programs	$ 394,582,437	$ 365,745,172
U.S. Court of Veterans Appeals funds	1,820,290	1,704,086
Technology initiatives	300,000	3,705,628
Grants from other funds	71,349	283,734
Grant recoveries	(112,374)	(181,505)
Total grant and contract expenses	$ 396,661,702	$ 371,257,115

NOTE 6 MANAGEMENT AND GRANTS OVERSIGHT

Management and grants oversight expenses for the years ended September 30, 2010 and 2009 were as follows:

	2010	2009
Compensation and benefits	$ 11,449,159	$ 9,917,209
Temporary employee pay	142,208	67,549
Consulting	933,677	686,858
Travel and transportation	689,808	494,432
Communications	121,042	132,567
Occupancy cost	1,708,406	1,654,289
Printing and reproduction	91,249	50,659
Other operating expenses	674,582	625,185
Capital expenditures	269,743	61,435
Total	16,079,874	13,690,183
Depreciation and amortization	312,261	215,810
Loss on disposal of assets	103	583
Less: capitalized assets	(266,293)	(60,960)
Total management and grant oversight expenses	$ 16,125,945	$ 13,845,616

NOTE 7 HERBERT S. GARTEN LOAN REPAYMENT ASSISTANCE PROGRAM

LSC initiated the Herbert S. Garten Loan Repayment Assistance Program in 2006 and loans were provided up to $5,000 annually for participating attorneys. In 2007, loans increased to $5,600 annually. For the years ended September 30, 2010 and 2009, participating attorneys received loans totaling $470,669 and $569,023, respectively, which have been included in accounts receivable.

NOTE 7 HERBERT S. GARTEN LOAN REPAYMENT ASSISTANCE PROGRAM (Continued)

The loans forgiven in fiscal years 2010 and 2009 totaled $527,162 and $279,400, respectively. Each loan and the related interest are to be forgiven provided that the participating attorneys successfully complete employment within the loan terms. No provision has been made in the accompanying financial statements to reflect any loss that may occur and no interest on the loans has been accrued as management has deemed these amounts to be immaterial.

NOTE 8 OFFICE OF INSPECTOR GENERAL

LSC's Office of Inspector General expenses for the years ended September 30, 2010 and 2009 were as follows:

	2010	2009
Compensation and benefits	$ 3,408,921	$ 2,977,165
Temporary employee pay	-	9,531
Consulting	92,844	65,570
Travel and transportation	164,906	145,626
Communications	16,012	22,138
Printing and reproduction	2,963	3,109
Other operating expenses	54,053	47,740
Capital expenditures	42,825	32,387
Total	3,782,524	3,303,266
Less: capitalized assets	(42,825)	(32,387)
Total Office of Inspector General expenses	$ 3,739,699	$ 3,270,879

NOTE 9 RETIREMENT PLANS

Pursuant to the Legal Services Corporation Act, all officers and employees hired before October 1, 1988, are participants in the Civil Service Retirement System ("CSRS"), although they are neither officers nor employees of the federal government. The CSRS, plan is administered by the United States Office of Personnel Management (OPM"). LSC makes contributions at rates applicable to agencies of the federal government. The contributions do not equal the full service cost of the pension expense, which is the actuarial present value of benefits attributed to services rendered by covered employees during the accounting period. The measurement of service cost requires the use of actuarial cost methods to determine the percentage of the employees' basic compensation sufficient to fund their projected pension benefit. These percentages (cost factors) are provided by OPM.

The excess of total pension expense over the amount contributed by LSC and by LSC employees represents the amount which must be financed directly by OPM. Several employees participate in the federal Employees Health Benefits plan ("FEHB"), also administered by the OPM. LSC pays the cost of current employees.

Post-retirement benefits are paid for by the OPM. No amounts have been recognized in the financial statements for these imputed costs as they are not deemed material. LSC does not report in its financial statements CSRS or FEHB assets, accumulated plan benefits or unfunded liabilities, if any, applicable to its employees.

Eligible employees may contribute up to 5% of their pretax earnings to the federal Thrift Savings Plan. Also, all officers and employees hired after September 30, 1988 are ineligible for the Civil Service Retirement System, but are eligible to participate in LSC's pension and thrift plan, which is a tax deferred annuity plan subject to Section 403(b) of the Internal Revenue Code. Individuals can make contributions up to the maximum permitted by law. LSC matches the first 2.51% contributed by the employee. In addition, LSC contributes 6% of each eligible employee's salary regardless of their participation to the maximum permitted under federal income tax rules

LSC's contributions to these plans for the years ended September 30, 2010 and 2009 were $973,980 and $858,469, respectively. These amounts are included in compensation and benefits for management and administration expenses. LSC also offers a tax deferred annuity savings plan for eligible employees. No contributions are made to this plan by LSC.

NOTE 10 LEASES

Related Party Lease

On June 1, 2003, LSC commenced an operating lease agreement for office space with the Friends of Legal Services Corporation ("FoLSC"), a nonprofit corporation whose primary purpose is to carry out activities that benefit LSC. Although LSC does not exert control or significant influence over the management or operations of FoLSC, the relationship of the two organizations is such that arms-length transactions may not be achieved.

The lease agreement provides for a non-escalating annual base rent for a 10-year term and has no obligation to pay a portion of building operating expenses. LSC has the right to terminate the lease by giving no less than 120-day prior written notice in the event that LSC does not receive an appropriation from Congress for administrative costs sufficient to cover LSC and its rental obligations for any period during the term of the lease. Future minimum lease payments required under this lease are as follows:

September 30,	Amount
2011	$ 1,710,000
2012	1,710,000
2013	1,710,000
Total	$ 5,130,000

Rental expense for each of the years ended September 30, 2010 and 2009 was $1,710,000. No amounts were due to or due from FoLSC as of September 30, 2010 and 2009.

Sublease

During fiscal year 2005, LSC entered into a five-year sublease to lease a portion of its space. The lease agreement provided for an annual base rent of $53,415 with a 2% annual increase. The sublease expired during fiscal year 2010.

Total sublease income recognized in fiscal year 2010 was approximately $4,824 and was reported as a reduction of rental expense in the accompanying financial statements.

NOTE 11 CONTINGENCIES

Grants and Contracts

LSC receives its funding from appropriations by Congress and grants from the U.S. Court of Veterans Appeals and, accordingly, may be subject to federal audits. In addition, LSC provides significant funding to several independent organizations, which are subject to their own independent audits and audits by LSC. LSC's management does not expect any significant adjustments as a result of federal audits should they occur or from the audits of the grantees' independent auditors.

LSC receives substantially all of its revenue from direct federal government appropriations. Should a significant level of reduction occur in this revenue, LSC's programs and activities might be negatively affected.

Claims

LSC is defending three cases in litigation involving challenges to LSC regulations, two of which have been consolidated. In the consolidated cases, plaintiffs are seeking injunctive relief but no monetary damages, except for attorneys' fees. The third case (LASO) involves a claim for injunctive relief but no monetary damages except for costs. Prior to 2008, the fees in these cases were paid by LSC's insurance carriers, but one carrier disputed coverage. LSC sued the carriers and settled in fiscal year 2008 for approximately $400,000. All future legal fees in these cases will be paid directly by LSC out of normal operating funds, and not be reimbursed by insurance carriers. No funds have been recorded in the financial statements for any contingent liability associated with future legal fees.

There is one further case, which was filed in December 2008 but which has never been served. In that case, plaintiff claims wrongful denial of legal representation by a LSC grantee. The suit appears to be entirely without merit. No outside counsel has been retained and no attorneys' fees or costs have been incurred.

LSC does not believe the result of these claims will have a material negative effect on its financial statements.

NOTE 11 CONTINGENCIES (Continued)

Reclassification of employees from exempt to non-exempt

Certain individuals may be misclassified as exempt from overtime and may be due wages for hours worked in excess of forty hours per week. Although none of these individuals has yet asserted a misclassification or failure to pay overtime claim against LSC, LSC has sought legal advice with respect to the potential liability, should any claim be made, strategy for resolving the matters, re-classifying these employees, and analysis of potential cost to resolve any overtime issues prior to claims being filed. LSC is in the process of estimating the time that it believes each individual may claim to have worked overtime based on observation and experience working with each of them. As no claims have been made, it is not certain at this time whether the employees will agree with LSC's time estimates. LSC believes it has sufficient funds in available to make any payment without affecting current operations.

NOTE 12 TAX STATUS

Under Section 501(c)(3) of the Internal Revenue Code, LSC is exempt from the payment of taxes on income other than net unrelated business income. No provision for income taxes was required for the years ended September 30, 2010 and 2009 as LSC had no net unrelated business income.

In June 2006, FASB ASC 740-10, *Accounting for Uncertainty in Income Taxes,* was issued. FASB ASC 740-10 clarifies the accounting and disclosure for uncertain tax positions, and prescribes a threshold of more-likely-than-not for recognition and derecognition of tax positions taken or expected to be taken in a tax return. During the year ended September 30, 2010, LSC adopted FASB ASC 740-10 and believes there is no impact on its financial statements.

LSC evaluates its uncertain tax positions using the provisions of FASB ASC 450, *Accounting for Contingencies*. Accordingly, a loss contingency is recognized when it is probable that a liability has been incurred as of the date of the financial statements and the amount of the loss can be reasonably estimated. The amount recognized is subject to estimates and management judgment with respect to the likely outcome of each uncertain tax position. The amount that is ultimately sustained for an individual uncertain tax position or for all uncertain tax positions in the aggregate could differ from the amount recognized. There were no liabilities for uncertain tax positions as of September 30, 2010 and 2009.

NOTE 13 SUBSEQUENT EVENTS

In preparing these financial statements, LSC has evaluated events and transactions for potential recognition or disclosure through January 7, 2011, the date the financial statements were issued.

Continuing Resolution

For fiscal year 2011, the House Appropriations Committee has proposed to increase LSC's funding to $440 million and the Senate Appropriations Subcommittee has recommended an increase to $430 million. The LSC Board had requested that Congress approve $516.5 million for fiscal year 2011. Congress had not approved the fiscal year 2011 appropriation for LSC by October 1, 2010; therefore LSC began the new fiscal year operating at fiscal year 2010 funding levels, under a Continuing Resolution signed into law on December 22, 2010. The new continuing resolution will provide funding through March 4, 2011.

LEGAL SERVICES CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEARS ENDED SEPTEMBER 30, 2010 AND 2009

Mission

The Legal Services Corporation's mission is to promote equal access to justice in our nation and to ensure the provision of high-quality civil legal assistance to low-income persons.

Organization

Legislation establishing the Legal Services Corporation (LSC) as an independent 501(c)(3) nonprofit organization was enacted in 1974. LSC is governed by an 11-member Board of Directors appointed by the President of the United States and confirmed by the U.S. Senate.

LSC is the single largest source of funding for civil legal assistance for low-income individuals and families. LSC provides grants to 136 programs, which operate as independent nonprofit organizations with their own boards of directors. Substantially all of LSC's funding comes from the Congress, and more than 95 percent of the annual congressional appropriation is distributed to these programs through a competitive grants process. LSC provides guidance, training and oversight to ensure the programs provide high-quality legal services and comply with congressional restrictions, LSC rules and regulations.

The Corporation's largest offices provide oversight of LSC grantees:

- The Office of Program Performance ("OPP") administers the competition of LSC grants and provides guidance to ensure LSC-funded programs provide high-quality legal services that are responsive to the needs of clients.

- The Office of Compliance and Enforcement ("OCE") reviews grantee compliance with the LSC Act, with congressional restrictions on the use of LSC funds and with LSC regulations and instructions.

In addition to the above offices, LSC has a statutorily independent Office of Inspector General (OIG), established in 1989, to conduct and supervise audits, investigations and reviews to detect waste, fraud and abuse and to assist management in identifying ways to promote efficiency and effectiveness in LSC operations and LSC-funded programs. The annual LSC appropriations act, which includes a separate budget line for the OIG, places additional responsibility with the Inspector General for monitoring grantee compliance with congressional restrictions through annual audits performed by independent public accountants. It also specifies the OIG's authority to conduct its own reviews of grantee compliance.

Other major LSC offices include the Office of Legal Affairs, Office of Information Management and Office of Information Technology.

Delivery of Civil Legal Assistance

The people who come to LSC-funded programs for civil legal assistance are the most vulnerable among us and are as diverse as our nation, encompassing all races, ethnic groups and ages, including the working poor, homeowners and renters facing foreclosure or eviction, families with children, veterans, farmers, people with disabilities, victims of domestic violence and victims of natural disasters. Persons eligible for LSC-funded services are at or below 125 percent of the federal poverty guidelines; in 2010, that was an income of $27,563 for a family of four.

About 57 million people are eligible for LSC-funded services, according to the most recent U.S. Census Bureau count, for the year 2009. That represents an increase of about 3 million people from the prior year.

The nation has endured two years of significant job losses following the 2008 recession, and the pace of economic growth has not been as vigorous as expected. The economic downturn has brought high unemployment, falling incomes and increased hardship in low-income communities across the nation. LSC-funded programs are unable to meet all the civil legal needs in their communities and often must settle for providing many applicants with less than full representation.

In fiscal year 2009, LSC programs closed 31,000 more cases than during the previous year, a 4 percent increase. The data, which is the most recent reported to LSC by grantees, showed that the number of unemployment compensation cases grew by 63 percent, food-stamp cases jumped 37 percent, and foreclosure cases doubled. LSC-funded programs project they will continue to see increased requests for assistance in fiscal years 2011 and 2012 related to the economic downturn and to upcoming changes in Medicaid law that will make more people with disabilities eligible for health care.

An overwhelming unmet demand already existed for civil legal services before the recession. LSC reported on this demand in 2005, in a report titled *Documenting the Justice Gap in America: The Current Unmet Civil Legal Needs of Low-Income Americans*. In September 2009, LSC updated and expanded the report, which shows the difference between the level of civil legal assistance available and the level that is necessary to meet the needs of low-income Americans.

Data collected from LSC-funded programs across the nation in fiscal year 2009 confirmed the conclusion of the 2005 report—that there continues to be a major gap between the civil legal needs of low-income people and the legal help they receive. For every client served by an LSC-funded program, one eligible person who actually sought help was turned down because of insufficient resources. In one category, foreclosures, LSC-funded programs turned away two people for every client served.

LEGAL SERVICES CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEARS ENDED SEPTEMBER 30, 2010 AND 2009

Overview of Financial Statements

The annual financial report presents LSC's financial position and results on operations in three parts: 1) Management's Discussion and Analysis (this section); 2) the basic comparative financial statements, and 3) notes to the financial statements.

The Management's Discussion and Analysis provides a useful overview of LSC's financial position and results of operations for fiscal years 2010 and 2009, and an overview of the fiscal year 2010 operating budget experience.

Financial Highlights

LSC receives its financial support from a congressional appropriation and its derivative income and a grant from the U.S. Court of Veterans Appeals. Any remaining funds from one year's budget are included in the next year's budget to support the next year's activities.[1]

For fiscal year 2010, LSC operated under a Continuing Resolution at 2009 funding levels until December 16, 2009. President Obama signed into law an appropriation of $420 million, an increase of approximately $30 million from the prior fiscal year. Most of the fiscal year 2010 appropriation, $394.4 million, was provided by the Congress for basic field grants for the provision of civil legal assistance for low-income Americans.[2]

The following tables show the critical elements of the budgets and their breakdown for fiscal years 2010 and 2009:

[1] In recent years, LSC has received annual funding from the State Justice Institute in support of LSC's Technology Initiative Grants program. The Institute suspended its 2010 contribution pending resolution of audit recommendations made by the LSC Office of Inspector General.

[2] Because Congress had not approved the Fiscal Year 2011 appropriation for LSC by October 1, 2010, the Corporation began the new Fiscal Year operating at Fiscal Year 2010 funding levels, under a Continuing Resolution signed into law on December 22, 2010.

LEGAL SERVICES CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEARS ENDED SEPTEMBER 30, 2010 AND 2009

Table 1- For the year ended September 30, 2010

	(1) Fiscal Year 2010 Appropriation	(2) Fiscal Year 2009 Carryover	(3) Court of Veterans Appeals, State Justice Institute and Adjustments	(4) Fiscal Year 2010 Consolidated Operating Budget
I. DELIVERY OF LEGAL ASSISTANCE				
1. Basic Field programs	$ 394,400,000	$ 1,100,413	$ -	$ 395,500,413
2. U.S. Court of Veterans Appeals funds	-	312	1,820,000	1,820,312
3. Grants from other funds	-	832,443	-	832,443
4. Technology initiatives	3,400,000	7,962	-	3,407,962
TOTAL	397,800,000	1,941,130	1,820,000	401,561,130
II. MANAGEMENT & GRANTS OVERSIGHT	17,000,000	3,502,693	-	20,502,693
III. HERBERT S. GARTEN LOAN REPAYMENT ASSISTANCE PROGRAM	1,000,000	1,691,442	-	2,691,442
IV. OFFICE OF INSPECTOR GENERAL	4,200,000	1,734,434	-	5,934,434
TOTAL BUDGET	$ 420,000,000	$ 8,869,699	$ 1,820,000	$ 430,689,699

Table 1.1- For the year ended September 30, 2009

	(1) Fiscal Year 2009 Appropriation	(2) Fiscal Year 2008 Carryover	(3) Court of Veterans Appeals, State Justice Institute and Adjustments	(4) Fiscal Year 2009 Consolidated Operating Budget
I. DELIVERY OF LEGAL ASSISTANCE				
1. Basic Field programs	$ 365,800,000	$ 1,045,585	$ -	$ 366,845,585
2. U.S. Court of Veterans Appeals funds	-	4,398	1,700,000	1,704,398
3. Grants from other funds	-	934,673	-	934,673
4. Technology initiatives	3,000,000	383,591	330,000	3,713,591
TOTAL	368,800,000	2,368,247	2,030,000	373,198,247
II. MANAGEMENT & GRANTS OVERSIGHT	16,000,000	1,646,898	(400,000)	17,246,898
III. HERBERT S. GARTEN LOAN REPAYMENT ASSISTANCE PROGRAM	1,000,000	470,842	500,000	1,970,842
IV. OFFICE OF INSPECTOR GENERAL	4,200,000	837,699	-	5,037,699
TOTAL BUDGET	$ 390,000,000	$ 5,323,686	$ 2,130,000	$ 397,453,686

The next two tables show abbreviated Statements of Financial Position and Statements of Activities for fiscal years 2010 and 2009:

Table 2
Statements of Financial Position

	September 30	
	2010	**2009**
Assets		
Total current assets and other assets	$ 84,456,815	$ 78,744,070
Net property and equipment	391,997	395,244
Total assets	$ 84,848,812	$ 79,139,314
Liabilities		
Grants and contracts payable	$ 69,431,311	$ 68,335,697
Other liabilities	1,369,958	1,538,673
Deferred revenue	6,418,891	2,800,129
Total liabilities	77,220,160	72,674,499
Net Assets		
Unrestricted net assets:		
Designated	553,445	835,863
Undesignated	6,683,210	5,233,708
Net investment in fixed assets	391,997	395,244
Total net assets	7,628,652	6,464,815
Total liabilities and net assets	$ 84,848,812	$ 79,139,314

The financial statements are a series of related reports that detail financial information using accounting methods similar to those used by other not-for-profits. For example, when reviewing the total unrestricted net assets of the Statement of Financial Position, it shows that the total unrestricted net assets increased from $6,464,815 to $7,628,652. Table 3 shows that this change in unrestricted assets increased $1,163,837 and $2,056,412 for the years ended September 30, 2010 and 2009, respectively.

Table 3
Statements of Activities

	September 30 2010	September 30 2009
Support and Revenue		
Federal appropriations	$ 420,000,000	$ 390,000,000
Grant revenue	1,820,290	2,059,086
General revenues		
Change in deferred revenue	(3,619,052)	(1,395,641)
Interest and other income	17,107	45,977
Total support and revenue	418,218,345	390,709,422
Expenses		
Program activities	396,661,702	371,257,115
Supporting activities	20,392,806	17,395,895
Total expenses	417,054,508	388,653,010
Change in net assets	1,163,837	2,056,412
Net assets, beginning of year	6,464,815	4,408,403
Net assets end of year	$ 7,628,652	$ 6,464,815

Fiscal Year 2010 MGO Budgetary Analysis and Activity Description

Table 4 presents the final budgets for Management and Grants Oversight (MGO) for fiscal years 2010 and 2009.

Table 4
Management and Grants Oversight
Operating Budget for 2010 and 2009

Budget Category	2010	2009
Compensation and benefits	$ 14,260,725	$ 11,238,200
Temporary employee pay	188,150	89,150
Consulting	1,338,900	1,093,050
Travel and transportation	1,053,900	924,750
Communication	168,000	184,350
Occupancy cost	1,718,100	1,681,800
Printing and reproduction	102,400	113,800
Other operating expenses	1,050,518	1,719,298
Capital expenditures	622,000	202,500
Total	$ 20,502,693	$ 17,246,898

Grants oversight and an emphasis on proper financial management practices are priorities of LSC's Board of Directors, management and staff. The delivery of legal services is provided by the 136 LSC-funded programs with more than 900 offices, and their local boards of directors are the linchpins in ensuring that these grantees provide high-quality civil legal assistance to clients.

During fiscal year 2010, the Corporation continued to enhance its capacity to perform grantee oversight. OPP added two full-time equivalent positions (only one is currently filled), and OCE added six full-time staff positions (five are currently filled).

LSC issued a revised Accounting Guide in August 2010, and LSC staff participated in trainings at conferences to orient grantees on the revised Accounting Guide. LSC also participated in a training session on effective board governance held at the Equal Justice Conference that was sponsored by the Center for Legal Aid Education.[3] During fiscal year 2010, LSC staff continued

[3] Additional LSC training sessions were held at the Annual Conference of the National Legal Aid & Defender Association in Atlanta, Ga., November 10-13, 2010.

to provide assistance to grantees, through the Board Governance Working Group and the Fiscal Operations Working Group.

For fiscal year 2010, LSC anticipated that it would establish a training unit to develop web-based and in-person training for grantee boards and staffs. The establishment of a special training unit is contingent on an increase in LSC's appropriation. In the interim, to facilitate training and collaborations, LSC has purchased video-conferencing technology that will be ready for use in January 2011.

In fiscal year 2010, OPP focused on the quality of legal services provided by grantees, using LSC's Performance Criteria as its primary guide. OPP's assessment of grantee delivery systems included reviews of grantee priorities, intake systems, outreach activities, legal work management and supervision, pro bono and private attorney involvement, board governance, leadership, resource development and strategic planning.

OPP during fiscal year 2010:

- Assessed the performance of 21 programs in 20 states and territories to ensure the delivery of high-quality civil legal assistance.
- Performed brief visits or technical assistance visits to 21 programs in 19 states and territories to learn more about grantee activities or to follow-up on prior concerns.
- Evaluated 53 proposals for funding for 81 service areas in 26 states and territories, including one multiple applicant area.
- Selected 40 new Technology Initiative Grants (TIG), totaling more than $3.5 million.[4] TIG supports state and local projects, including initiatives with state courts. In rural areas, technology helps grantees deliver services more efficiently.
- Administered the Herbert S. Garten Loan Repayment Assistance Program (LRAP) to encourage retention of recent law school graduates at LSC grantees. Recipients ranged from new hires to attorneys with up to three years of service with the grantee. A total of 94 attorneys in 51 programs received LRAP awards.
- Continued to provide coordination for grantees experiencing natural disasters, including guidance to LSC-funded programs in 23 disasters, including the Deep Horizon oil spill, during the fiscal year. LSC also renewed its Memorandum of Understanding with the American Red Cross to facilitate cooperation among LSC programs and Red Cross chapters.

During fiscal year 2010, OCE assessed the policies and procedures adopted by grantees in such areas as client income eligibility, legal assistance provided, use of non-LSC funds, subgrants and several statutory prohibitions.

[4] TIG awards were made in December 2010.

During fiscal year 2010, OCE:

- Conducted 12 Case Service Report/Case Management System (CSR/CMS) reviews and eight follow-up reviews.
- Reviewed and acted on 23 audit findings referred by the Office of Inspector General.
- Opened 46 complaints against grantees for violations of the LSC Act, regulations and guidelines, and closed 69 complaints.
- Reviewed and approved 68 subgrants.
- Reviewed 227 audited financial statements for fiscal years 2008, 2009 and 2010 to ensure compliance with the LSC Accounting Guide.
- Reviewed and approved fund balances at grantees, acting on 26 fund balance waiver requests.
- Addressed specific concerns regarding grantees, including two special grant assessment visits to one grantee, an intake assessment visit in conjunction with OPP to a grantee, and a fiscal review visit to ensure a grantee's compliance with corrective actions on a questioned cost.
- Provided CSR training for grantees and training for new executive directors.

LSC's Board of Directors also has undertaken initiatives, such as holding quarterly roundtable discussions with grantees to learn first-hand about the challenges of providing legal services in low-income communities. In July 2010, the Board established a Special Task Force on Fiscal Oversight, charged with reviewing LSC's fiscal oversight responsibilities and how LSC conducts fiscal oversight of its grantees. The Task Force is expected to issue a report, and possible recommendations, in 2011.

Furthermore, in accepting a recommendation by the Government Accountability Office in June 2010, LSC has committed to engage an outside expert to develop and perform a full evaluation and assessment of LSC's competitive grants process. The outside expert's review will include conducting a risk-based assessment of the internal control of the grant evaluation, award and monitoring process; recommendations of additional internal control options; recommendations of options for maximizing information reporting capabilities, and a report on internal controls and options implemented.

Note 6 under Notes to Financial Statements presents the final expenses for MGO for fiscal years 2010 and 2009.

Fiscal Year 2010 OIG Budgetary Analysis and Activity Description

Table 5 presents the final operating budgets for the OIG for fiscal years 2010 and 2009.

Table 5
Office of Inspector General
Operating Budgets for Years Ended September 2010 and 2009

Budget Category	2010	2009
Compensation and benefits	$ 3,747,100	$ 3,263,301
Temporary employee pay	25,000	50,624
Consulting	467,000	393,932
Travel and transportation	266,000	251,917
Communication	38,000	38,363
Occupancy cost	1,000	1,000
Printing and reproduction	4,150	6,034
Other operating expenses	1,246,184	968,528
Capital expenditures	140,000	64,000
Total	$ 5,934,434	$ 5,037,699

The OIG has two principal duties pursuant to the Inspector General Act: (1) to assist the Board and management by identifying ways to promote economy, efficiency and effectiveness in the activities and operations of LSC and its grantees; and (2) to prevent and detect fraud, waste, and abuse. Congress also gave the OIG oversight responsibility to ensure the quality and integrity of the financial and compliance audits performed by independent public accountants (IPAs). In addition, the OIG conducts on-site reviews of grantees as appropriate. To accomplish its mission, the OIG is guided by its own multi-year strategic plan for fiscal years 2007-2011.

The fiscal year 2010 OIG budget funded reviews of external grant recipients, IPAs, and internal LSC management operations and activities.

External grant recipient and IPA focused projects included:

- Reviews of 136 grantee audit reports with referral of all significant findings to LSC management for resolution;

- Audits of LSC grant recipients of Capital Area Legal Services Corporation (LA), Bay Area Legal Aid (CA), Northwest Justice Project (WA), and Legal Aid Society of

Cleveland (OH) identifying internal control weaknesses and recommending corrective actions to remedy those weakness and collect questioned costs;

- Several audit quality reviews of the IPAs' grant recipient audits;
- Investigations and subsequent prosecutions of significant theft or embezzlement of grant recipient funds (in one case in excess of $1 million);
- Investigations related to compliance matters;
- Fraud awareness briefings, fraud vulnerability assessments, and related reviews; and
- A nationwide hotline for reporting suspected fraud, waste or abuse in recipient programs.

Additionally, the OIG continued its involvement in a litigation effort seeking subpoena enforcement in support of an investigation of alleged violations of Congressional restrictions by an LSC grantee.

Projects reviewing selected LSC management operations and activities included:

- An on-going audit of LSC's Technology Initiative Grant program for which management comments have been received and are being evaluated;
- Oversight of the fiscal year 2009 LSC corporate audit;
- Management Information Memorandum regarding grantees' executive directors conducting outside legal practice;
- Several reviews conducted in response to Congressional inquiries;
- Comments on significant proposed legislation, regulations and policy initiatives affecting LSC including the proposed reauthorization legislation for LSC and the Civil Access to Justice Act of 2009; and
- Participation as a full member of the Council of the Inspectors General for Integrity and Efficiency and on its various committees and working groups.[5]

Note 8 under Notes to Financial Statements presents the final operating expenses for the OIG for fiscal years 2010 and 2009.

[5] The full activities of the OIG are presented in detail in the OIG's Semiannual Reports to Congress, posted to the OIG website at http://www.oig.lsc.gov/ as released.

The budget and expense tables display that the OIG's budget and expenses were greater in fiscal year 2010. Respectively, the OIG budget was $896,735 and expenses were $479,258 greater in fiscal year 2010. The OIG has taking a fiscally prudent approach to expending its increased funding by making incremental increases in OIG operations primarily through the hiring of additional professional staff to increase the OIG field presence.

Grants from Other Funds

Grants from other funds are derived from grant recoveries and have been earmarked by the Board of Directors for special and/or emergency program needs. In fiscal year 2010, LSC provided $300,000 to Bay Area Legal Services for a new office in St. Petersburg, Florida. The grantee is proud to report that the new office is centrally located, provides easy access for clients and "demonstrates Bay Area Legal Services' commitment to serving the public and providing access to legal services".

Fixed Assets and Long-Term Debt

Categories of fixed assets are reported in Tables 6 and 7 for fiscal years 2010 and 2009. There is no debt activity relating to fixed assets.

Table 6
Fixed Assets
Fiscal Year 2010

	Beginning Balance	Additions	Disposals	Ending Balance
Furniture	$ 1,824,982	$ 182,298	$ (67,826)	$ 1,939,454
Software	341,201	64,849	-	406,050
Leasehold improvements	321,687	61,970	(31,959)	351,698
	2,487,870	309,117	(99,785)	2,697,202
Less: accumulated depreciation/ amortization	(2,092,626)	(312,261)	99,682	(2,305,205)
Total fixed assets, net	$ 395,244	$ (3,144)	$ (103)	$ 391,997

Table 7
Fixed Assets
Fiscal Year 2009

	Beginning Balance	Additions	Disposals	Ending Balance
Furniture	$ 1,783,581	$ 77,345	$ (35,944)	$ 1,824,982
Software	326,349	14,852	-	341,201
Leasehold improvements	320,537	1,150	-	321,687
	2,430,467	93,347	(35,944)	2,487,870
Less: accumulated depreciation/ amortization	(1,912,177)	(215,810)	35,361	(2,092,626)
Total fixed assets, net	$ 518,290	$ (122,463)	$ (583)	$ 395,244

Major Challenges

The low-income Americans who come to LSC grantees often have nowhere else to turn. LSC supports a nationwide network of legal aid providers who keep families together, keep roofs over their heads, find solutions to pressing civil legal problems at crucial moments and put people back on their feet.

Poverty rates increase during recessions, and the poor are among the first impacted and among the last to recover. The weak economy holds the prospect of adversely affecting many low-income neighborhoods because of continuing high unemployment and property foreclosures.

Providing legal services to low-income Americans is a daunting challenge, and the need for basic legal services is large and growing. And while the need for civil legal assistance is increasing, the economic downturn has put a great strain on the resources that support legal services.

In addition to grants provided by LSC, many legal aid nonprofit organizations rely on state funding, Interest on Lawyers' Trust Accounts (IOLTA) grants, and charitable contributions. Because of state budget shortfalls and a protracted economic recovery, LSC-funded programs expect to see flat funding or continued decreases of their non-LSC resources.

The impact of the IOLTA decline varies by state, but numerous LSC-funded programs are receiving less IOLTA funding, and projections for the next two years are not encouraging. In 2009, IOLTA income plummeted 57 percent nationwide. IOLTA funding at LSC programs was $84.9 million in 2009, a decrease of nearly $27 million, or 24 percent, compared to 2008. The impact of IOLTA funding for 2010 will be available during 2011 spring.

LSC grants in fiscal year 2009 represented about 42 percent of the total resources that LSC grantees receive. If state funding, charitable contributions and IOLTA revenue drops significantly in the next year, the federal share of funding for legal aid nonprofit organizations will take on new urgency.

LSC cannot fully realize its mission without securing more financial resources from the Congress. For fiscal year 2011, the House Appropriations Committee has proposed to increase LSC's funding to $440 million and the Senate Appropriations Subcommittee has recommended an increase to $430 million. The LSC Board had requested that Congress approve $516.5 million for fiscal year 2011.

For fiscal year 2011, the House Appropriations Committee has proposed to increase LSC's funding to $440 million and the Senate Appropriations Subcommittee has recommended an increase to $430 million. The LSC Board had requested that Congress approve $516.5 million for fiscal year 2011. Congress had not approved the fiscal year 2011 appropriation for LSC by October 1, 2010; therefore LSC began the new fiscal year operating at fiscal year 2010 funding levels, under a Continuing Resolution signed into law on December 22, 2010. The new continuing resolution will provide funding through March 4, 2011.

Because deficit reduction has emerged as a priority for Congress and the White House in 2011, funding will be an ongoing challenge for the Corporation. LSC and grantees will likely face significant challenges on how to meet the growing demand for legal services in an uncertain budget climate.

An additional challenge facing LSC in fiscal year 2011 involves changes in corporate leadership. On September 29, 2010, the U.S. Senate confirmed the final four presidential nominees to LSC's Board of Directors. They join seven appointees who were confirmed earlier in 2010 and in 2009. The new Board is expected to select a new president for the Corporation in late 2010 or early 2011, and the Board will play an important role in developing new five-year Strategic Directions for LSC.

In pursuit of the OIG Strategic Plan's goals and objectives, the OIG will perform audit, evaluation and investigative fact-finding activities in accordance with the Inspector General Act and the LSC appropriations law. The OIG will continue to carry out its Congressionally-assigned responsibility to oversee the IPAs' grantee audits, conduct reviews of grantees' internal controls, financial processes, and compliance therewith, conduct audits and investigations, maintain a hotline, and evaluate the effectiveness and efficiency of LSC and its grant recipient operations.

LSC also will be negotiating its first union contract. Professional employees in OPP and OCE voted in September 2009 to be represented by the International Federation of Technical and Professional Engineers and elected leadership representatives in fiscal year 2010.

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

The Audit Committee of the Board of Directors
The Inspector General
Legal Services Corporation
Washington, DC

We have audited the financial statements of the Legal Services Corporation ("LSC") as of and for the year ended September 30, 2010 and have issued our report thereon dated January 7, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

<u>Internal Control Over Financial Reporting</u>
In planning and performing our audit, we considered LSC's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of LSC's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of LSC's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters
As part of obtaining reasonable assurance about whether LSC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

We noted certain matters that we reported to management of LSC in a separate letter dated January 7, 2011.

This report is intended solely for the information and use of management, the Audit Committee of the Board of Directors, the Office of Inspector General, the Board of Directors, others within LSC, and the United States Congress, and is not intended to be used by anyone other than those specified parties.

Washington, DC
January 7, 2011
Thompson, Cobb, Bazilio & Associates, PC

Legal Services Corporation

Report of Deficiencies in Internal Control Over Financial Reporting and Other Matters

TCBA

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The Audit Committee of the Board of Directors
The Office of Inspector General
Legal Services Corporation
Washington, DC

In connection with our audit of the financial statements of LSC as of and for the year ended September 30, 2010, we identified deficiencies in internal control over financial reporting (control deficiencies).

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A deficiency in design exists when a control necessary to meet the control objective is missing, or when an existing control is not properly designed so that even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when a properly designed control does not operate as designed or when the person performing the control does not possess the necessary authority or qualifications to perform the control effectively.

A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented, or detected and corrected on a timely basis.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Following are descriptions of identified control deficiencies that we determined did not constitute significant deficiencies or material weaknesses:

1. Performance Evaluations Not Being Performed Timely

Condition: We selected eighteen employees and reviewed the related employee personnel files for documentation of current performance evaluations. Out of the total employees selected, seven employees were temporary. For the remaining eleven employees, we noted staff performance evaluations were returned for only two employees and the evaluations for the nine employees were still outstanding.

Effect: An essential part of developing a powerful work team is assessing each employee's contribution to the organization. Delays in effective communication of employees' performance can result in control weaknesses.

Cause: Management initially set a deadline of August 15th for completion of the evaluations; however, due to a reduction in senior management staff, managers are dealing with numerous priorities as LSC has a new Board of Directors along with managing in a union environment for the first time in thirty-five years.

Recommendation: Effective communication of job expectations and evaluations is crucial for improving efficiency and accountability in operations. Timely documentation of employee performance evaluations will reduce the chance of employee dissatisfaction or even lawsuits, which are often stimulated by subjective evaluations and perceived bias. We recommend that LSC implement procedures to ensure employee performance evaluations are performed and documented on a timely basis.

Management Response: Most evaluations for 2009 have been completed; however, there are few employees for whom the evaluation conferences must still be conducted. In addition, LSC has a Union that started in the last quarter of fiscal year 2010; however, the Collective Bargaining Agreement (CBA) with the Union has not been negotiated yet. Therefore, the Union has opposed LSC conducting evaluations throughout this year. Management decided in the spring of 2010 to conduct and complete evaluations even though no performance pay will be associated with the evaluations for the period January 1, 2009 – December 31, 2009. This decision was based on the fact that management is required to maintain the status quo during the interim period until we have entered into a CBA with the union. Management expects to complete the remaining evaluations in the next thirty to forty-five days.

2. Long Outstanding Liabilities and Compliance Issues for Technology Initiative Grants

Condition: During our 2009 audit, we noted that Technology Initiative Grants (TIG) payable included grants which were long outstanding. TIG grants are disbursed in installments based on the grantees' completion of agreed-upon milestones which are stated in the grant award letters. The grantees can submit requests for extensions to meet the original deadlines for completion of milestones, and in most cases, extensions are granted. Prior to 2009, new TIG grants were often awarded to grantees that had not completed milestones under previous grant awards. In addition, due to the lack of adequate termination procedures, non-performing grants were not terminated on a timely basis. When some of the grants are terminated, the funds obligated have not been made available to other viable projects in a timely manner. The condition of long outstanding liabilities under TIG grants remained in effect in 2010; however, the number of grantees that had outstanding balances prior to fiscal year 2009 was reduced significantly in 2010 from 75 to 51.

Criteria: Sound financial and cash management require that payables are monitored and reviewed regularly. Effective grantee selection and monitoring require implementing policies to encourage grantees to comply with the terms of grant agreements.

Effect: There is little incentive for the grantees to complete the projects in a timely manner if milestone extensions are routinely granted.

The following table summarizes TIG payables which were outstanding prior to fiscal year 2009:

September 30, 2009	**Amount Outstanding**
2008	$ 1,082,652
2007	558,264
2006	176,039
2005	178,470
2004	351,129
2003	160,452
2002	168,728
2001	102,013
2000	10,872
	$ 2,788,619

During 2010, the outstanding TIG payable balance increased to $3,137,342. This includes $2,003,404 for current 2009 projects and $341,395 for 2008 projects, many of which are not overdue, which leaves a balance of just over $792,543 for 2007 and earlier grants. In fiscal year 2010, 149 payment requests totaling $1,565,710 on 2008 and prior grants were processed. The following table summarizes TIG payables which were outstanding prior to fiscal year 2010:

September 30, 2010	**Amount Outstanding**
2009	$ 2,003,404
2008	341,395
2007	289,725
2006	76,627
2005	104,470
2004	146,461
2003	72,298
2002	69,949
2001	33,013
	$ 3,137,342

Cause: Based on our discussion with management, extensions for milestones and grant periods can be granted, and grant cycles run two to three years. In addition, it appears that TIG grant liabilities are not periodically reviewed.

Recommendation: We recommend that management implement procedures to perform periodic reviews of long outstanding TIG grant payables and take appropriate actions in order to ensure compliance with LSC's laws, regulations and policies.

Management Response: Management considers strong internal controls to be a vital part of all of its grants management and oversight operations. Management has prepared a draft TIG Policies and Procedures Manual and is incorporating the recommendations of the OIG into the existing process of designing and implementing a revised system of internal control for the TIG program. This includes tighter procedures for granting extensions for milestone completions and other report requirements. Moreover, effective 2009, TIG awards may not be made to any applicant that has not made satisfactory progress on all TIG grants previously awarded to it. Management is working on building the capability in LSC's online grants management system to allow TIG grantees to submit milestone adjustment requests via the online system and for LSC to send automated email reminders to TIG grantees about reporting deadlines.

In response to the OIG report, LSC placed the termination of existing grants on hold until the concerns raised in the report could be addressed. The procedures governing grant terminations have been standardized as have the notices that are given to grantees. The details of the financial reporting to be required by grantees prior to terminations are close to being finalized. Once these have been approved, OPP expects to focus resources on the termination of overdue grants.

3. No Formal Mechanism for Granting and Revoking Logical Access to Network and Applications

Observation: Access controls ensure that only authorized personnel have access to systems and programs within LSC's network. Such controls are particularly important with respect to information technology assets that could be used to gain unauthorized access to files, programs, and databases that are critical to LSC and affiliate financial operations. We observed certain exceptions within the preventive, detective, and corrective procedures. Specifically, we observed that the access request forms for granting and revoking logical access to LSC's network and applications were not approved by the system owner and signed by the user and his or her supervisor.

Criteria: Access controls ensure that only authorized personnel have access to systems and programs within LSC's network. Such controls are particularly important with respect to information technology assets that could be used to gain unauthorized access to files, programs, and databases that are critical to LSC and affiliate operations.

Ensuring reliable access controls are in place and operating effectively involves implementing and monitoring preventive, detective, and corrective procedures that address the various access risk points. Preventative procedures generally address the first risk point that involves initiating or granting access and include documented access policies and procedures and supporting documentation for approvals that grant access to systems/programs/networks, as well as maintaining these policies and procedures updated as practices change. Detective procedures generally address the second risk point that involves activities after access has been obtained and include monitoring of user accounts for compliance with logical access parameters, revoking access privileges for terminated users, and reviewing audit trail logs. Corrective procedures generally address the third and final risk point that involves taking actions that remediate matters that do not comply with policies and procedures identified through the preventive and/or detective procedures.

Effect: The risks of unauthorized access to LSC's systems and possible changes to sensitive data increases without a formal mechanism for granting and revoking logical access to LSC's systems.

Cause: Management felt that using an informal notification system (email) was effective and did not implement a more robust process.

Recommendation: We recommend that LSC add the appropriate signature lines to the Access Request Form to allow for user, system owner and user's supervisor approval. The Access Request Form should circulate from the HR Department to the user's supervisor, then to the user, then on to the system owner, and finally to the IT staff in the OIT department. The date should also be added to the signatures lines. It is critical that users' access profiles are documented and available for review by auditors and relevant stakeholders.

Management Response: OIT currently uses an Access Request Form (currently internal to OIT) for tracking user access. OIT will modify this Request Form to allow for user, system owner and user's supervisor approval of user's detailed access. The Access Request Form will be made available to the HR department to circulate starting at HR department then to the user's supervisor, then to the user, then on to the system owner and finally to the IT staff in the OIT department. The date will also be added to the signature lines. The HR department will use this Access Request Form for new employees and employees leaving LSC. OIT will also make this Access Request Form available to supervisors allowing them to request access modification for their employees' access to systems and programs within LSC's network. OIT will retain all Access Request Forms within Worksite for documentation purposes and make the Access Request Forms available for review by auditors and relevant stakeholders.

This communication is intended solely for the information and use of management, the Audit Committee of the Board of Directors, the Office of Inspector General, the Board of Directors, others within LSC, and the United States Congress, and is not intended to be used by anyone other than these specified parties.

Washington, DC
January 7, 2011

Thompson, Cobb, Bazilio & Associates, PC

Legal Services Corporation

Report to the Audit Committee of the Board of Directors and the Office of Inspector General

January 28, 2011

TCBA

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January 28, 2011

The Audit Committee of the Board of Directors
The Office of Inspector General
Legal Services Corporation

To the Members of the Audit Committee and the Office of Inspector General:

We are pleased to present this report related to our audit of the financial statements of the Legal Services Corporation ("LSC") for the year ended September 30, 2010. This report summarizes certain matters required by professional standards and to be communicated to you in your oversight responsibility for LSC's financial reporting process.

This report is intended solely for the information and use of the Audit Committee of the Board of Directors, Office of Inspector General, the Board of Directors, and others within LSC, and is not intended to be used by anyone other than these specified parties. It will be our pleasure to respond to any questions you have about this report. We appreciate the opportunity to be of service to LSC.

Thompson, Cobb, Bazilio & Associates, PC

Legal Services Corporation
Required Communications
Year Ended September 30, 2010

Statement on Auditing Standards No. 114 requires the auditor to communicate certain matters to keep those charged with governance adequately informed about matters related to the financial statement audit that are, in our professional judgment, significant and relevant to the responsibilities of those charged with governance in overseeing the financial reporting process. The following summarizes these communications.

Area	Comments
Auditor's Responsibility Under Professional Standards	Our responsibility under auditing standards generally accepted in the United States of America has been described to you in our engagement letter dated June 30, 2010.
Accounting Policies	**Adoption of Accounting Policies** Management has the ultimate responsibility for the appropriateness of the accounting policies used by LSC. There were no new accounting policies adopted by management during the 2010 audit. **Significant or Unusual Transactions** We did not identify any significant or unusual transactions or significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus. **Critical Accounting Policies and Practices** See Note 1 of the Financial Statements for a description of LSC's critical accounting policies and practices identified by management. We believe management's disclosures regarding such policies and practices are adequate. **Alternative Treatments Discussed with Management** There were no alternative treatments discussed with management during the 2010 audit.
Management Judgments and Accounting Estimates	Depreciation is an accounting estimate. Property and equipment are stated at cost and depreciated using the straight-line method over the estimated useful lives of the assets of five and ten years.
Financial Statement Disclosures	The financial statement disclosures are adequate.
Audit Adjustments	There were no audit adjustments.

Legal Services Corporation
Required Communications
Year Ended September 30, 2010

Area	Comments
Uncorrected Misstatements	There are no uncorrected misstatements.
Disagreements with Management	We encountered no disagreements with management over the application of significant accounting principles, the basis for management's judgments on any significant matters, the scope of the audit or significant disclosures to be included in the financial statements.
Consultations with Other Accountants	We are not aware of any consultations management had with other accountants about accounting or auditing matters.
Major Issues Discussed with Management Prior to Retention	No major issues were discussed with management prior to our retention to perform the audit.
Difficulties Encountered in Performing the Audit	We did not encounter any difficulties in dealing with management relating to the performance of the audit.
Letter Communicating Significant Deficiencies and Material Weaknesses	We did not identify any significant deficiencies and material weaknesses during our audit. We identified control deficiencies and other matters that are communicated in a separate letter.