



WithumSmith+Brown
A Professional Corporation
Certified Public Accountants and Consultants

Legal Services Corporation

Financial Statements

September 30, 2008 and 2007

With Independent Auditors' Report



Inspector General
Jeffrey E. Schanz

MEMORANDUM

TO: Board of Directors
Legal Services Corporation

FROM: Jeffrey E. Schanz
Inspector General 

SUBJ: Transmittal of FY 2008 Financial Statement Audit Report

DATE: January 28, 2009

The Office of Inspector General (OIG) contracted with the independent certified public accounting firm of WithumSmith+Brown, P.C. to audit the financial statements of the Legal Services Corporation (LSC) as of September 30, 2008 and 2007. The audit was 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 Report by WithumSmith+Brown, P.C. stated that LSC's financial statements present fairly, in all material respects, the financial position of LSC as of September 30, 2008 and 2007, and the results of its operations and changes in its fund balance for the years then ended in conformity with accounting principles generally accepted in the United States.

The Independent Auditor's Report on Compliance and Other Matters identified an issue with the classification of certain workers as independent contractors rather than employees. The Report stated that LSC has not taken appropriate steps to ensure it is in compliance with Internal Revenue Code 3121 and related laws and regulations. LSC stated that it plans to take action to address this issue.

OIG reviewed the audit report from WithumSmith+Brown, P.C. and related audit documentation and inquired of their representatives. 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, or conclusions about compliance with applicable laws and regulations, or the effectiveness of internal controls. WithumSmith+Brown, P.C. is responsible for the attached auditor's report, dated January 6, 2009, along with the conclusions expressed in the report.

However, OIG's review disclosed no instances in which WithumSmith+Brown, P.C. did not comply, in all material respects, with generally accepted government auditing standards.

Attachment

cc: Helaine Barnett
President

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

Charles Jeffress
Chief Administrative Officer

**Legal Services Corporation
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September 30, 2008 and 2007**

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Independent Auditors' Report

To Inspector General and Board of Directors,
Legal Services Corporation:

We have audited the accompanying statements of net assets and governmental fund balance sheets of Legal Services Corporation ("LSC") as of September 30, 2008 and 2007, and the related statements of activities and governmental fund revenues, expenditures, and changes in fund balance 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 the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit 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, 2008 and 2007, and the results of its operations and changes in its fund balance for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis which includes budget comparison information for the year ended September 30, 2008, on pages 3–15 is required supplementary information in accordance with the Governmental Accounting Standards Board and precedes the basic financial statements. We have applied certain limited procedures, which consisted principally of inquires of management regarding the methods of measurements and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.



In accordance with *Government Auditing Standards*, we have also issued our report dated January 6, 2009 on our consideration of LSC's internal controls 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.

William Smith + Brown, PC

January 6, 2009

Legal Services Corporation Management's Discussion and Analysis For Years Ending September 30, 2008 and 2007

Mission

The Legal Service Corporation's mission is to promote equal access to justice in our nation and to provide high-quality civil legal assistance to low-income persons.

Organization

Legislation establishing the Legal Services Corporation as a private, nonprofit, federally funded corporation was enacted in 1974. LSC is governed by an 11-member board appointed by the president and confirmed by the Senate.

The Corporation is the single largest source of funding for civil legal aid for low-income individuals and families. LSC funds 137 programs, which operate as independent nonprofits with their own boards of directors. Substantially all of the Corporation's funding comes from the Congress, and more than 95 percent of the annual congressional appropriation is distributed to these programs through competitive grants. LSC provides guidance, training and oversight to ensure that 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 administers the competition for LSC grants and provides oversight to ensure LSC-funded programs provide high-quality legal services that are responsive to the needs of clients.

The Office of Compliance and Enforcement reviews grantee compliance with the LSC Act, with congressional restrictions on LSC funds and with LSC regulations and instructions.

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

Office of Inspector General

In addition to the above offices, the LSC has a statutorily independent Office of Inspector General, established in 1988, to conduct and supervise audits, investigations and reviews to detect fraud and abuse and to assist management in identifying ways to promote efficiency, and effectiveness in LSC operations and programs. The LSC Appropriations Act, which includes a separate budget line for the OIG, places additional responsibility with the OIG for monitoring grantee compliance with congressional restrictions via annual audits performed by independent public accountants. It also specifies the OIG's authority to conduct its own reviews of grantee compliance.

Overview of the Financial Statements

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

Management's Discussion and Analysis provides a useful overview of LSC's financial positions with respect to assets for FY 2008 and FY 2007, and an overview of the FY 2008 operating budget experience.

The Basic Financial Statements include two financial statements: the Statements of Net Assets and Governmental Fund Balance Sheets; and the Statements of Activities and Governmental Fund Revenues, Expenditures, and Change in Fund Balances. These statements are presented for the periods ending September 30, 2008, and 2007, so that readers may compare year-to-year balances. The financial

**Legal Services Corporation
Management's Discussion and Analysis
For Years Ending September 30, 2008 and 2007**

statements are presented in accordance with accounting principles generally accepted in the United States of America as promulgated by the Governmental Accounting Standards Board. The Statement of Net Assets and Governmental Fund Balance Sheet summarizes the net assets that are available to pay outstanding liabilities. The resulting balance is the amount of funds available to support next year's operations. The Statement of Activities and Governmental Fund Revenues, Expenditures, and Changes in Fund Balances provides the results of the identified year's operations.

Notes to the Financial Statements provide further details on specific items contained in the tables in Part 2.

Financial Highlights

LSC receives its support from a federal appropriation and its derivative income, a grant from the U.S. Court of Veterans Appeals and from a partnership with the State Justice Institute, which supports LSC's Technology Initiative. Any remaining funds from one year's budget are included in the next year's budget to support the next year's activities.

The Management and Administration (M&A) account has received essentially flat funding for the last five years. M&A received \$243,000 less funding for fiscal 2008 when compared to fiscal 2007, and M&A funding is down \$700,000 over the past five years.

In part because the M&A account did not keep pace with inflation, transportation and payroll costs, LSC was forced to reprogram \$500,000 in FY 2008 to avert a budget shortfall in the M&A account in FY 2009. Until 2008, the Corporation had absorbed rising costs through a combination of carryover funds and interest income. But carryover funds have been greatly diminished and interest income has declined sharply as a result of greatly reduced interest rates.

The reprogramming was required in order to avoid a reduction-in-force (RIF) because of a Continuing Resolution that will run through March 6, 2009. The resolution maintains the Corporation at FY 2008 budget levels until Congress completes the appropriations process and provides a FY 2009 budget. With the permission of Congress, LSC reprogrammed the \$500,000 from the pilot Loan Repayment Assistance Program (LRAP) for FY 2008 to M&A. The LRAP account was selected because the Corporation would not be issuing checks to LRAP participants until FY 2009, and LSC received an additional \$500,000 for LRAP in the FY 2009 Continuing Resolution.

**Legal Services Corporation
Management's Discussion and Analysis
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**Table 1
Statement of Net Assets**

	September 30	
	2008	2007
Total Current Assets and Other Assets	\$ 68,029,086	\$ 68,249,559
Net Property and Equipment	<u>518,290</u>	<u>577,838</u>
Total Assets	<u>\$ 68,547,376</u>	<u>\$ 68,827,397</u>
Grants and Contracts Payable	\$ 61,513,267	\$ 59,611,053
Other Liabilities	1,192,131	1,565,886
Deferred Revenue	<u>1,433,575</u>	<u>2,663,896</u>
Total Liabilities	<u>64,138,973</u>	<u>63,840,835</u>
Net Assets		
Fund Balances	3,890,113	4,408,724
Investment in capital assets	<u>518,290</u>	<u>577,838</u>
Total Net Assets	<u>4,408,403</u>	<u>4,986,562</u>
Total Liabilities and Net Assets	<u>\$ 68,547,376</u>	<u>\$ 68,827,397</u>

Table 2 presents a comparison of 2008 and 2007 revenues. In 2008, the federal appropriation, a grant from the U.S. Court of Veterans Appeals, partnership funds from the State Justice Institute and other revenues totaled \$354,078,688, and expenditures for program activities and support activities totaled \$354,656,847. In 2007, revenues totaled \$348,192,917, and expenditures for program activities and support activities were \$347,655,098. Table 2 provides a review of each year's operating results.

Operations in 2008 yielded a decrease to the net assets of \$578,159. When this amount, which is shown in the Statement of Activities and Governmental Fund Revenues, Expenditures and Changes in Fund Balance, is added to the prior year's balance, the year-end net assets total \$4,408,403. This compares to the increase in net assets in FY 2007 of \$537,819, which resulted in year-end net assets of \$4,986,562.

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**Table 2
Change in Net Assets**

	Years ended September 30,	
	<u>2008</u>	<u>2007</u>
Revenue		
Federal appropriations	\$ 350,490,000	\$ 348,578,000
Grant revenue	1,510,000	1,596,379
General revenues		
Change in deferred revenue	1,230,321	(2,468,506)
Contributed services	163,570	
Interest & Other income	684,797	487,044
Total revenue	<u>354,078,688</u>	<u>348,192,917</u>
Expenses		
Program activities	337,143,611	331,373,708
Supporting activities	17,513,236	16,281,390
Total expenses	<u>354,656,847</u>	<u>347,655,098</u>
Change in net assets	(578,159)	537,819
Net Assets, beginning of year	<u>4,986,562</u>	<u>4,448,743</u>
Net Assets, end of year	<u>\$ 4,408,403</u>	<u>\$ 4,986,562</u>

Delivery of Legal Assistance

The clients of LSC-funded programs are among the most vulnerable among us, living at or below 125 percent of the federal poverty guideline—an income of \$26,500 for a family of four. Three out of four clients are women, many of whom are mothers struggling to keep their families together and their children safe, fed and housed.

They are of all races and ethnicities, young and old, the working poor, people with disabilities, families with children, veterans, victims of domestic violence and victims of natural disasters. LSC-funded programs make a meaningful difference in the lives of their clients—helping them secure basic human needs such as safe and habitable housing, an adequate source of income, access to needed health care, and protection from abusive relationships.

Legal aid helps reduce federal spending by preventing the downward spiral of the poor into costly public support. Ensuring that clients are adequately represented in the civil judicial system greatly improves their chances of keeping their home rather than moving into a shelter, holding a job rather than going onto public assistance, retaining custody and support of their children rather than losing them to foster care, receiving needed medical care before requiring expensive hospitalization, escaping an abusive relationship rather than suffering further injury or even death. In short, civil legal assistance saves lives and money.

Legal Services Corporation Management's Discussion and Analysis For Years Ending September 30, 2008 and 2007

The workload at many LSC-funded programs increased during fiscal 2008 because of the subprime mortgage crisis and the rise in foreclosures. Renters and senior citizens with fixed incomes are especially vulnerable to being displaced by foreclosure, and legal aid programs saw a dramatic increase in calls from people seeking assistance with housing and predatory lending matters.

LSC-funded programs responded to requests for such help in a variety of ways. Atlanta Legal Aid Society's Home Defense Project helped low-income homeowners fend off loan and refinance schemes that take equity out of homes or gain control of deeds and ownership rights. Legal Aid of North Carolina worked with creditors to negotiate solutions so that families can stay in their homes. Other LSC-funded programs being inundated with requests for legal assistance with foreclosures included those in Maine, Maryland, Missouri, Ohio, and New York City.

The economic downturn and the mortgage foreclosure crisis were not the only reasons LSC saw an increased demand for legal services. Natural disasters, such as Hurricanes Ike and Gustav, have devastated parts of Texas, Louisiana and Arkansas and increased the number of people without jobs, income and health care, while putting more poor people at risk of consumer fraud. Wildfires have prompted emergency declarations in California and Texas, and snowstorms led Ohio and Wisconsin to declare emergencies. Five Midwestern states suffered their worst flooding in a century this summer.

The Corporation's Texas and Louisiana programs are examples of the added workload caused by disasters. Lone Star Legal Aid has closed more than 10,000 hurricane-related cases since Katrina struck three years ago and has helped thousands through community outreach efforts—all before Ike hit on September 12, 2008. Texas RioGrande Legal Aid still has 100 cases open, out of 3,200 spawned by Katrina. Three 2008 hurricanes—Dolly, Gustav and Ike—added more than 1,700 new cases to the workload of Lone Star Legal Aid, and Dolly and Ike added more than 500 new cases at Texas RioGrande Legal Aid. New Orleans Legal Assistance continues to work on Katrina cases—about 70 percent of the legal problems handled by the program's housing and public benefits departments are related to Katrina. Long after the initial devastation of a natural disaster, low-income individuals and families continue to turn to legal aid attorneys for help in rebuilding their lives.

To strengthen the assistance provided to disaster victims, LSC and the American Red Cross entered into a memorandum of understanding on September 9, 2008 that will enhance cooperation and coordination during disasters. According to the memo, advocates employed by LSC grant recipients will have access to the Red Cross Service Delivery sites to conduct legal counseling. LSC also joined in September with three other organizations, including the American Bar Association, to launch a Web site (www.disasterlegalaid.org) that helps attorneys and individuals address legal issues that arise in the aftermath of major disasters.

Protecting Veterans' Rights

Since 1992, LSC has administered a veterans' pro bono program, funded, with congressional approval, through the U.S. Court of Appeals for Veterans Claims. The program provides legal representation on behalf of veterans who appeal adverse decisions by the Bureau of Veterans Affairs. LSC awards an annual grant to the Veterans' Consortium Pro Bono Program, which offers its services to veterans who do not have an attorney, assesses whether appellants' cases have merit, and then assigns cases with merit to pro bono attorneys it has recruited and trained. In 2007, the Consortium's pro bono representatives provided representation to 209 appellants before the Court of Appeals for Veterans Claims. The Consortium expects to provide representation to 231 appellants in 2008. For the last several years the veteran appellant has prevailed in three-fourths of the cases where they were represented by a Consortium pro bono attorney.

Legal Services Corporation Management's Discussion and Analysis For Years Ending September 30, 2008 and 2007

Expanding Services Through Technology

In an effort to help legal aid providers become more efficient and effective, LSC awarded \$2 million in technology grants to LSC programs. Since 2000, when the Technology Initiative Grant program began, LSC has awarded more than \$29 million in grants. The 2008 grants were used for technology that makes it easier for low-income Americans to apply for legal assistance, simplifies the creation of legal documents for those who are representing themselves in court and provides information through online chats, called LiveHelp. One LSC-funded program will use its grant to redesign portions of a Web site to make the content available via cell phone browsers.

Through the technology grant program, LSC helped the Legal Aid Society of Orange County, California, develop the I-CAN! E-File, a Web-based tax preparation program. During 2008, about 25,000 people used I-CAN! to prepare and submit their 2007 tax returns, allowing them to collect \$33 million in refunds. The program helps low-income working families collect their Earned Income Tax Credits without being charged excessive fees for tax preparation.

High-tech partnerships are a key to delivering legal services to the nation's poor. In 2008, LSC partnered with LexisNexis to launch the HotDocs Software Donation Program for legal aid programs. Through the program, LexisNexis provided free HotDocs software to eligible organizations, allowing them to save time by creating templates for documents that law offices use every day, such as court forms, real estate and lease agreements, contracts, correspondence and other material. The free software freed up thousands of dollars at programs for use elsewhere.

As technology improves, LSC is constantly exploring ways to use it as a tool to expand access to justice, by making self-help systems more available and by improving the efficiencies of programs to serve more low-income clients.

The unexpended Technology Initiative funds are to be used for future technology grants. Because the Technology Initiative funds have not been awarded, they are considered unearned and therefore reported as deferred revenue.

Strengthening Recruitment and Retention

LSC programs can only be as successful as the people who work in them, and LSC has sponsored a pilot Loan Repayment Assistance Program to recruit and retain talented attorneys. In 2008, nearly 300 attorneys at 55 LSC-funded programs applied to participate in LRAP. LSC plans to provide \$5,600 annually to 41 attorneys who work in 22 programs over the next three years. LSC's evaluation of the LRAP's first two years found that loan repayment assistance gives programs greater ability to hire and keep attorneys. Many newly hired attorneys are under financial pressure to leave their legal services programs to earn higher salaries. The Corporation's evaluation of LRAP found that participants had an average law school debt of \$84,150.

Grants From Other Funds

The 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. No awards were made this year; the full amount of funds available in FY 2009 remains available for future grants and is included with the Reserved Fund Balance.

For budgeting purposes and full reporting to LSC's Board of Directors (Board) and the public, there is a slight reporting difference between the management discussion and analysis tables, which are derived from the monthly interim financial reports, and the annual financial statements. The Program Budget versus Actual Expenditures table (Table 3) reports grant expenditures of \$337,230,321 exclusive of the Loan Repayment

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Assistance Program (which is not a grant program) and the Statement of Activities reports expenditures of \$337,143,611; the difference is \$86,710. This is the amount of FY 2008 Grant Recoveries and this total is shown during the year as revenue collected outside of the appropriations process. This reporting provides the Board with an opportunity to revise the budget to include the funds in the budget line for Grants from Other Funds and provide emergency grants from that line. However, when the annual financial statements are completed, the total Grant Recoveries are used to offset Grants expenditures in the Statement of Activities. The detail of this reporting is shown in the financial statements, Note 5 – Grants and Contracts Expense.

Table 3 provides the budget, expenditure, and variance information for each element of the Delivery of Legal Assistance. The unexpended balances from Basic Field, Court of Veterans Appeals, and Technology Initiatives are combined in the financial statements in Part 2 and are shown as Deferred Revenue.

**Table 3
Program Budget Versus Actual Expenditures**

	<u>Budget</u>		<u>Expenditures</u>		<u>Variance</u>
Basic Field Programs	\$ 335,026,714	\$	333,981,128	\$	1,045,586
U.S. Court of Veterans Appeals	1,227,577		1,223,179		4,398
Technology Initiatives	2,409,605		2,026,014		383,591
Loan Repayment Assistance Program	795,708		324,866		470,842
Grants From Other Funds	<u>847,963</u>		<u>0</u>		<u>847,963</u>
 Total	 <u>\$ 340,307,567</u>	 \$	 <u>337,555,187</u>	 \$	 <u>2,752,380</u>

The unexpended Basic Field Programs funds represent two grantee service areas. The first service area is for Nevada because Nevada Legal Services is on short-term funding due to compliance issues; and the second is for the 2008 and 2007 funding for American Samoa. Funding for the U'Unai Legal Services Clinic in America Samoa was terminated on March 15, 2007, due to compliance issues, and no replacement grantee provider has been identified. The unexpended U.S. Court of Veterans Appeals funds are to be used to support next year's grant.

Improving Governance and Accountability

To strengthen its internal operations, LSC spent much of fiscal 2008 strengthening and modernizing its governance and accountability practices.

The LSC Board adopted a Code of Ethics and Conduct for directors, officers and employees of the Corporation, and LSC conducted training on the new code for all employees and officers. The LSC Board reorganized its oversight functions, establishing a board Audit Committee and approving charters for all standing board committees.

After an evaluation of financial standards used by LSC, the Board decided to continue to use the Governmental Accounting Standards Board guidelines for LSC's financial reports. To better respond to emergencies and catastrophic events, LSC management established a comprehensive Continuity of Operations Plan. LSC management will present a rigorous risk management program to the Board in January 2009.

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During 2008, LSC management undertook an initiative to develop and implement policies for information sharing among the Office of Program Performance (OPP), Office of Compliance and Enforcement (OCE) and the Office of Inspector General and to improve coordination of program performance and compliance visits to LSC grantees. Under the initiative, OPP and OCE established a new protocol for information sharing, conducted in depth training sessions, and held quarterly staff meetings to continue coordination of work efforts. Recommendations by the Government Accountability Office were the catalyst for most of these changes, which were fully endorsed by the LSC board and management team.

LSC hosted an Executive Directors' Conference in June 2008 that brought together the leadership of all LSC-funded programs for two days of discussion on some of the most important topics confronting legal aid programs. The agenda covered such topics as grants management, internal financial controls, enhanced private attorney involvement, performance criteria, leadership mentoring, disaster planning, and improvements in quality. In comments sent to LSC after the conference, the Executive Directors said the gathering gave them a chance to discuss important issues, exchange ideas and information and learn more about their fellow executives.

The following table shows Management and Administration beginning and ending budgets.

**Table 4
Management & Administration
Original and Revised FY 2008 Operating Budget**

<u>Budget Category</u>	<u>Original Budget</u>	<u>Final Budget</u>	<u>Increase (Decrease)</u>
Compensation and benefits	\$ 10,215,085	\$ 10,225,310	\$ 10,225
Temporary employee pay	64,075	82,075	18,000
Consulting	943,775	1,074,175	130,400
Travel and transportation expenses	856,150	709,950	(146,200)
Communications	151,240	152,940	1,700
Occupancy cost	1,680,500	1,678,375	(2,125)
Printing and reproduction	113,100	113,100	0
Other operating expenses	611,525	1,188,025	576,500
Capital expenditures	214,900	151,400	(63,500)
Total	\$ 14,850,350	\$ 15,375,350	\$ 525,000

As a result of the quarterly expenditure reviews, internal budgetary adjustments were made to more closely align to this year's strategic initiatives. The original budget was increased \$525,000 because of a contribution of \$25,000 that was received to establish a Presidential Discretionary Fund and the \$500,000 reprogramming of LRAP funds to support FY 2009 management operating needs discussed earlier.

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Table 5 presents the final M&A budget and expenditures, as well as the budget category variances. Over half of the total variance is attributable to personnel compensation and benefits for positions that were vacant during FY 2008 and the \$500,000 LRAP reprogrammed funds that are shown in other operating expenses.

**Table 5
Management & Administration
Operating Budget versus Actual Expenditures**

Budget Category	Final Budget	Expenditures	Variance
Compensation and benefits	\$ 10,225,310	\$ 9,901,937	\$ (323,373)
Temporary employee pay	82,075	69,121	(12,954)
Consulting	1,074,175	1,029,113	(45,062)
Travel and transportation expenses	709,950	627,916	(82,034)
Communications	152,940	120,701	(32,239)
Occupancy cost	1,678,375	1,661,722	(16,653)
Printing and reproduction	113,100	64,986	(48,114)
Other operating expenses	1,188,025	601,357	(586,668)
Capital expenditures	151,400	74,965	(76,435)
Total	\$ 15,375,350	14,151,818	(1,223,532)
Depreciation and amortization		216,190	216,190
Loss on disposal of assets		1,139	1,139
Less: Capitalized assets		(74,965)	(74,965)
		\$ 14,294,182	\$ (1,081,168)

Legal Services Corporation Management's Discussion and Analysis For Years Ending September 30, 2008 and 2007

FY 2008 OIG Budgetary Analysis and Activity Description

The OIG has two principal duties pursuant to the Inspector General Act: (1) to assist the Board and management by identifying ways to promote 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 operates under its own multi-year strategic plan for the years 2007-2011. During FY 2008, Ronald D. Merryman served as the Acting Inspector General until March 2008, when Jeffrey E. Schanz was appointed by the LSC Board of Directors as the permanent LSC Inspector General.

The FY 2008 OIG budget funded reviews of external grant recipients, IPAs, and internal LSC management operations and activities.

Externally focused OIG projects included:

- Audits of selected internal control weaknesses at LSC grant recipients identified in the GAO Report entitled, *Legal Services Corporation – Improved Internal Controls Needed in Grants Management and Oversight* (five of these audit reports were issues during FY 2008);
- Reviews of 137 grantee audit reports with referral of significant findings to LSC management for resolution;
- Several audit quality reviews of the IPAs' grant recipient audits; and,
- Investigations related to compliance matters and theft or embezzlement of grantee funds, as well as fraud vulnerability reviews.

Additionally, the OIG continued its involvement in two important litigation efforts: seeking subpoena enforcement in support of an investigation of LSC grantee California Rural Legal Assistance's violations of Congressional restrictions; and, participating in discovery aspects of a lawsuit challenging LSC's program integrity regulation.

Internally focused projects, addressed to LSC management operations and activities, included:

- Responses to Congressional inquiries concerning the actions of the Board and management related to the GAO reports and related recommendations;
- Participation as an advisory member of a management task force that drafted a Code of Ethics and Conduct for application both to employees of the Corporation and to its Board of Directors;
- Assisting the LSC Board's Ad Hoc Committee and management in its efforts to develop appropriate policies in response to GAO recommendations regarding financial and compliance oversight;
- Assisting in the establishment of an Audit Committee;
- Oversight of the FY 2007 LSC corporate audit;
- Survey of personal and private information security within LSC; and,
- Comments on significant LSC regulatory and policy initiatives.

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Other noteworthy projects included the recent renovation of the OIG's office suite to create more needed work areas and meeting facilities from the existing space.

The OIG budget presentation in Table 6 contains a comparison of the original and final operating budget for FY 2008. During the fiscal year, no reallocations of monies across the budget categories were made.

**Table 6
Office of Inspector General
Original and Revised FY 2008 Operating Budget**

<u>Budget Category</u>	<u>Original Budget</u>	<u>Final Budget</u>	<u>Increase (Decrease)</u>
Compensation and benefits	\$ 3,094,000	\$ 3,094,000	\$ 0
Temporary employee pay	25,000	25,000	0
Consulting	327,701	327,701	0
Travel and transportation expenses	178,000	178,000	0
Communications	24,600	24,600	0
Occupancy cost	1,000	1,000	0
Printing and reproduction	4,200	4,200	0
Other operating expenses	62,200	62,200	0
Capital expenditures	98,000	98,000	0
Total	<u>\$ 3,814,701</u>	<u>\$ 3,814,701</u>	<u>\$ 0</u>

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For Years Ending September 30, 2008 and 2007**

Table 7 presents the OIG's FY 2008 final budget, expenditures, and budget category variances. The expenditure variances from the budget resulted from three and one-half unfilled budget positions related to the transition in OIG leadership, which entailed a hold on internal hiring and a delay in the suite renovation project required to accommodate planned additions to the OIG staff. The postponement of the OIG records management project resulted in variances in the consulting and other operating expenditure categories. Additionally, the OIG received a Congressional inquiry concerning LSC management practices which required a reallocation of personnel resources to internal work and resulted in variances in the travel expenditure category.

**Table 7
Office of Inspector General
Operating Budget versus Actual Expenditures**

<u>Budget Category</u>	<u>Final Budget</u>	<u>Expenditures</u>	<u>Variance</u>
Compensation and benefits	\$ 3,094,000	\$ 2,674,713	\$ (419,287)
Temporary employee pay	25,000	0	(25,000)
Consulting	327,701	39,167	(288,534)
Travel and transportation expenses	178,000	140,716	(37,284)
Communications	24,600	19,590	(5,010)
Occupancy cost	1,000	0	(1,000)
Printing and reproduction	4,200	2,286	(1,914)
Other operating expenses	62,200	17,716	(44,484)
Capital expenditures	98,000	82,815	(15,185)
Total	\$ 3,814,701	2,977,003	(837,698)
Depreciation and amortization		0	0
Loss on disposal of assets		0	0
Less: Capitalized assets		(82,815)	(82,815)
		\$ 2,894,188	\$ (920,513)

The OIG provides the LSC and Congress with independent and objective assessments of opportunities to be more successful. In pursuit of the OIG Strategic Plan's goals and objectives, the OIG will perform audit, evaluation, and investigative activities in accordance with the IG Act and the LSC appropriations law. The OIG will continue to carry out its Congressionally-assigned responsibility to oversee the IPAs' grantee audits, conduct its own reviews of grantees compliance, conduct audits and investigations, maintain a hotline, and evaluate the effectiveness and efficiency of LSC and its grant recipient operations.

**Legal Services Corporation
Management’s Discussion and Analysis
For Years Ending September 30, 2008 and 2007**

Capital Assets and Long-term Debt

Categories of capital assets are reported in Table 8. There is no short or long-term debt activity regarding capital assets.

**Table 8
Capital Assets**

	<u>2008</u>	<u>2007</u>
Furniture and Equipment	\$ 286,103	\$ 367,185
Software	79,970	79,970
Leasehold Improvements	<u>152,217</u>	<u>130,683</u>
Total Capital Assets (net)	<u>\$ 518,290</u>	<u>\$ 577,838</u>

Major Challenges

The need for basic legal services is large and growing. Nearly 51 million people—including 19.7 million women and 17.6 million children, are eligible for LSC-funded services, according to the most recent Census data. The ranks of the nation’s poor will increase as the recession continues into 2009. There can be no doubt that low-income Americans will be most severely impacted by the recession.

An overwhelming unmet demand already existed for civil legal services before the economic downturn, as documented in the Corporation’s Justice Gap Report. In order to close the justice gap, federal funding for civil legal aid to the poor would have to at least double from the 2005 level just to serve those who actually sought help and were eligible to receive it. In addition to the doubling of federal funds, other sources of funding, such as state, local and private funding, would also have to double.

Currently, LSC funds represent 42 percent of the total resources that LSC grantees receive. While non-LSC funding has increased over the years, the forecasts indicating substantial growth in funds derived from Interest on Lawyers’ Trust Accounts (IOLTA) are being replaced with lower expectations because of a decline in interest rates. The recession also will likely reduce private contributions to legal aid programs.

As mentioned earlier, access to justice for civil matters can be expanded through partnerships. LSC has supported efforts by judges to build support for access to justice. Many state supreme courts have created access to justice commissions, and judges often encourage pro bono efforts. The LSC board is using LSC’s national voice and its initiative “Help close the justice gap, unleash the power of pro bono” to encourage enhanced private attorney involvement as an effective tool for providing legal services to more persons in need. Ninety-six LSC-funded programs have adopted resolutions in support of increased pro bono assistance.

But LSC cannot fully realize its mission without securing more financial resources from the Congress. The federal government must lead the way, consistent with its role in maintaining the formal civil justice system, providing an orderly forum for the resolution of disputes, and providing an avenue to equal justice for all. The Legal Service Corporation’s mission is to promote equal access to justice in our nation and to provide high-quality civil legal assistance to low-income persons.

Basic Financial Statements

Legal Services Corporation
Statement Of Net Assets And Governmental Fund Balance Sheet
September 30, 2008

	<u>General Fund</u>	<u>Adjustments (Note A)</u>	<u>Statement of Net Assets</u>
Assets			
Cash and cash equivalents	\$ 67,452,106	\$	\$ 67,452,106
Grant recovery receivable	5,058		5,058
Loans and other receivables	339,699		339,699
Prepaid expenses and deposits	232,223		232,223
Capital assets (net)		518,290	518,290
	<u>\$ 68,029,086</u>	<u>\$ 518,290</u>	<u>\$ 68,547,376</u>
Liabilities			
Grants and contracts payable	\$ 61,513,267	\$	\$ 61,513,267
Accounts payable	226,334		226,334
Accrued vacation and other liabilities	965,797		965,797
Deferred revenue	1,433,575		1,433,575
Total Liabilities	<u>64,138,973</u>		<u>64,138,973</u>
Fund Balances / Net Assets			
Fund balances:			
Reserved	1,326,304		
Unreserved	2,563,809		
Total fund balances	<u>3,890,113</u>		
Total liabilities and fund balances	<u>\$ 68,029,086</u>		
Net assets:			
Invested in capital assets, net of related debt		518,290	518,290
Restricted		3,890,113	3,890,113
Total Net Assets		<u>\$ 4,408,403</u>	<u>4,408,403</u>
			<u>\$ 68,547,376</u>

Note A: Reconciliation of fund balance to total net assets.

Amounts reported for governmental activities in the statement of net assets are different because:

Fund balance	\$ 3,890,113
Capital assets used in governmental activities are not financial resources, and, therefore, are not reported in the fund financial statements	518,290
Total net assets	<u>\$ 4,408,403</u>

The Notes to Financial Statements are an integral part of these statements.

Legal Services Corporation
Statement Of Net Assets And Governmental Fund Balance Sheet
September 30, 2007

	<u>General Fund</u>	<u>Adjustments (Note A)</u>	<u>Statement of Net Assets</u>
Assets			
Cash and cash equivalents	\$ 67,002,866	\$	\$ 67,002,866
Grant recovery receivable	450,000		450,000
Loans Receivable	348,919		348,919
Accounts Receivable	7,263		7,263
Prepaid expenses and deposits	440,511		440,511
Capital assets (net)		577,838	577,838
	<u>\$ 68,249,559</u>	<u>\$ 577,838</u>	<u>\$ 68,827,397</u>
Liabilities			
Grants and contracts payable	\$ 59,611,053	\$	\$ 59,611,053
Accounts payable	726,312		726,312
Accrued vacation and other liabilities	839,574		839,574
Deferred Revenue	2,663,896		2,663,896
Total Liabilities	<u>63,840,835</u>		<u>63,840,835</u>
Fund Balances / Net Assets			
Fund balances:			
Reserved	1,026,656		
Unreserved	3,382,068		
Total fund balances	<u>4,408,724</u>		
Total liabilities and fund balances	<u>\$ 68,249,559</u>		
Net assets:			
Invested in capital assets, net of related debt		577,838	577,838
Restricted		4,408,724	4,408,724
Total Net Assets		<u>\$ 4,986,562</u>	<u>4,986,562</u>
			<u>\$ 68,827,397</u>

Note A: Reconciliation of fund balance to total net assets.

Amounts reported for governmental activities in the statement of net assets are different because:

Fund balance	\$ 4,408,724
Capital assets used in governmental activities are not financial resources, and, therefore, are not reported in the fund financial statements	577,838
Total net assets	<u>\$ 4,986,562</u>

The Notes to Financial Statements are an integral part of these statements.

Legal Services Corporation
Statement of Activities And Governmental Fund Revenues, Expenditures, and Changes
in Fund Balance
Year Ended September 30, 2008

	<u>General Fund</u>	<u>Adjustments (Note A)</u>	<u>Statement of Activities</u>
Expenditures/Expenses			
Grants	\$ 337,143,611	\$	\$ 337,143,611
Board of Directors	169,166		169,166
Executive Office	895,116		895,116
Legal Affairs	1,391,466		1,391,466
Governmental Relations and Public Affairs	668,060		668,060
Human Resources	505,351		505,351
Financial and Administrative Services	2,920,300	(6,767)	2,913,533
Information Technology	1,368,847	(67,060)	1,301,787
Program Performance	3,115,043		3,115,043
Information Management	594,474		594,474
Compliance and Enforcement	2,435,491		2,435,491
Executive Director's National Conference	88,505		88,505
Office of Inspector General	2,977,003	(82,815)	2,894,188
Loan Repayment Assistance Program	324,866		324,866
Depreciation/amortization		216,190	216,190
	<u>354,597,299</u>	<u>59,548</u>	<u>354,656,847</u>
Program Revenues			
Federal Appropriations	350,490,000		350,490,000
U.S. Court of Veterans Appeals Funds	1,210,000		1,210,000
State Justice Institute	300,000		300,000
Change in deferred revenue	1,230,321		1,230,321
	<u>353,230,321</u>		<u>353,230,321</u>
General Revenues			
Contributed services	163,570		163,570
Interest and other income	684,797		684,797
	<u>848,367</u>		<u>848,367</u>
Excess of revenues over expenses	(518,611)	518,611	
Change in net assets		(578,159)	(578,159)
Fund Balance/net assets:			
Beginning of the year	4,408,724		4,408,724
Invested in capital assets, net		577,838	577,838
Net Assets, End of the year	\$ <u>3,890,113</u>	\$ <u>518,290</u>	\$ <u>4,408,403</u>

The Notes to Financial Statements are an integral part of these statements.

Legal Services Corporation
Statement of Activities And Governmental Fund Revenues, Expenditures, and Changes
in Fund Balance
Year Ended September 30, 2008

Note A: Reconciliation of the statements of revenues, expenditures, and changes in fund balance of governmental funds in the statement of activities.

Amounts reported for governmental activities in the statement of activities are different because:

Excess of revenues over expenditures	\$	(518,611)
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Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which depreciation exceeded capital outlays expense during the current period.

(59,548)

Change in net assets	\$	<u>(578,159)</u>
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Fund balance:			
Beginning of year	\$	4,408,724	
Net change		<u>(518,611)</u>	
End of year		<u>3,890,113</u>	\$ 3,890,113

To include capital assets (net) used in governmental activities in the statement of activities, which are not reported in fund financial statements

Excess of revenues over expenditures	518,611	
Change in net assets	(578,159)	
Capital assets, beginning	<u>577,838</u>	
Capital assets (net)	\$ <u>518,290</u>	518,290

Total net assets	\$	<u><u>4,408,403</u></u>
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Legal Services Corporation
Statement of Activities And Governmental Fund Revenues, Expenditures, and Changes
in Fund Balance
Year Ended September 30, 2007

	<u>General Fund</u>	<u>Adjustments (Note A)</u>	<u>Statement of Activities</u>
Expenditures/Expenses			
Grants	\$ 331,373,708	\$	\$ 331,373,708
Board of Directors	172,599		172,599
Executive Office	814,621		814,621
Legal Affairs	1,209,863		1,209,863
Governmental Relations and Public Affairs	678,872		678,872
Human Resources	490,417		490,417
Financial and Administrative Services	2,812,438	(1,205)	2,811,233
Information Technology	1,204,719	(104,452)	1,100,267
Program Performance	3,061,124		3,061,124
Information Management	625,336		625,336
Compliance and Enforcement	2,361,236		2,361,236
Office of Inspector General	2,539,779	(41,646)	2,498,133
Loan Repayment Assistance Program	201,619		201,619
Depreciation/amortization		256,070	256,070
	<u>347,546,331</u>	<u>108,767</u>	<u>347,655,098</u>
Program Revenues			
Federal Appropriations	348,578,000		348,578,000
U.S. Court of Veterans Appeals Funds	1,260,000		1,260,000
State Justice Institute	336,379		336,379
Change in deferred revenue	(2,468,506)		(2,468,506)
	<u>347,705,873</u>		<u>347,705,873</u>
General Revenues			
Interest and other income	487,044		487,044
	<u>487,044</u>		<u>487,044</u>
Excess of revenues over expenses	646,586	(646,586)	
Change in net assets		537,819	537,819
Fund Balance/net assets:			
Beginning of the year	3,762,138		3,762,138
Invested in capital assets, net		686,605	686,605
Net Assets, End of the year	<u>\$ 4,408,724</u>	<u>\$ 577,838</u>	<u>\$ 4,986,562</u>

The Notes to Financial Statements are an integral part of these statements.

Legal Services Corporation
Statement of Activities And Governmental Fund Revenues, Expenditures, and Changes
in Fund Balance
Year Ended September 30, 2007

Note A: Reconciliation of the statements of revenues, expenditures, and changes in fund balance of governmental funds in the statement of activities.

Amounts reported for governmental activities in the statement of activities are different because:

Excess of revenues over expenditures	\$	646,586
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Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which depreciation exceeded capital outlays expense during the current period.

(108,767)

Change in net assets	\$	<u>537,819</u>
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Fund balance:			
Beginning of year	\$	3,762,138	
Net change		<u>646,586</u>	
End of year		<u>4,408,724</u>	\$ 4,408,724

To include capital assets (net) used in governmental activities in the statement of activities, which are not reported in fund financial statements

Excess of revenues over expenditures	(646,586)	
Change in net assets	537,819	
Capital assets, beginning	<u>686,605</u>	
Capital assets (net)	\$ <u>577,838</u>	577,838

Total net assets	\$	<u><u>4,986,562</u></u>
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Legal Services Corporation
Notes to the Financial Statements
September 30, 2008 and 2007

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.

Financial Statement Presentation

LSC's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). For financial reporting purposes, LSC is considered a governmental not-for-profit organization and follows the pronouncements of the Governmental Accounting Standards Board (GASB). The GASB is responsible for establishing U.S. GAAP for state, local, and other special purpose governments through its pronouncements (Statements and Interpretations). Governments are also required to follow the pronouncements of the Financial Accounting Standards Board (FASB) issued through November 30, 1989, (when applicable) that do not conflict with or contradict GASB pronouncements. LSC's Management's Discussion and Analysis ("MD&A") is considered to be required supplemental data and precedes the financial statements.

GASB Statement No. 34, as amended, requires that governmental financial statements include a government-wide Statement of Net Assets and Statement of Activities (reporting LSC as a whole) and fund financial statements that include a Governmental Fund Balance Sheet and a Statement of Governmental Fund Revenues, Expenditures, and Changes in Fund Balance (reporting financial transactions of LSC's major fund). For financial reporting purposes, LSC follows the guidance in GASB 34, as amended, for a special purpose government engaged in a single governmental program and, as such, may combine its fund financial statements with its government-wide statements. A summary reconciliation of the fund financial data with the government-wide data is presented on the combined financial statements.

LSC has no proprietary or fiduciary funds; therefore, no cash flows or fiduciary statements are presented.

Basis of Accounting

The basis of accounting refers to the point at which revenues and expenses are recognized. It relates to the timing of the measurements made regardless of the measurement focus used.

The government-wide statements are presented on the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred.

The fund financial statements are presented on a modified basis of accrual. Revenues are recorded when they are both measurable and available, which means collectible within the current period or within 60 days after year-end. Expenditures are recognized when the related liability is incurred. The focus in the fund statements is on sources and uses of resources rather than on net income.

Cash and Cash Equivalents

LSC's cash and cash equivalents includes a fund balance with U.S. Treasury of \$37,973,519 and \$32,989,241 at September 30, 2008 and 2007, respectively.

Property and Equipment

Capital assets are stated at cost and depreciated using the straight-line method over the estimated useful lives of the assets of five to ten years. Depreciation is reported as an unallocated expense and is not directly identified with individual functions.

Legal Services Corporation
Notes to the Financial Statements
September 30, 2008 and 2007

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.

Revenues

The federal appropriations are reported as program revenue in the period expended. The appropriation remains available until expended and unexpended grant funds are shown as deferred revenue.

Fund Balance / Net Assets

The Board of Directors, through its fund allocation process, has designated \$1,326,304 and \$1,026,656 of the fund balance for continuing programs and administrative activities as of September 30, 2008 and 2007, respectively. Net assets are reported as restricted due to constraints imposed for their use by Congressional appropriation legislation.

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.

LSC records a Grant Recovery Receivable when it is probable that LSC will require a grantee to return all or a portion of resources already received, in the amount LSC is expected to reclaim. As of September 30, 2008 and 2007, grant recovery receivables totaled \$5,058 and \$450,000, respectively. No allowance for uncollectible receivables has been recorded, as management deems these fully collectible.

Estimates

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

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.

Concentration of Revenue

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

Legal Services Corporation
Notes to the Financial Statements
September 30, 2008 and 2007

2. Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a bank failure, LSC's deposits may not be returned to it. LSC invests cash balances in excess of predefined target balances through repurchase agreements with two financial institutions. As of September 30, 2008, \$12,357,137 of LSC's bank balance of \$29,476,587, and as of September 30, 2007, \$15,335,184 of LSC's bank balance of \$34,011,625 was exposed to custodial credit risk as follows:

	2008	2007
Uninsured and uncollateralized	\$ -0-	\$ -0-
Uninsured and collateral held by pledging bank's trust department not in LSC's name	<u>12,357,137</u>	<u>15,335,184</u>
Total	<u>\$ 12,357,137</u>	<u>\$ 15,335,184</u>

3. Equipment

Property and equipment consists of the following at September 30, 2008

	Beginning Balance	Additions	Disposals	Ending Balance
Furniture and equipment	\$ 1,806,058	\$ 43,342	\$ (65,820)	\$ 1,783,580
Software	277,087	49,262		326,349
Leasehold improvements	255,361	65,176		320,537
Subtotal	<u>2,338,506</u>	<u>157,780</u>	<u>(65,820)</u>	<u>2,430,466</u>
Less: Accumulated depreciation/amortization	<u>1,760,668</u>	<u>216,190</u>	<u>(64,681)</u>	<u>1,912,177</u>
Capital assets (net)	<u>\$ 577,838</u>	<u>\$ (58,410)</u>	<u>\$ (1,139)</u>	<u>\$ 518,290</u>

Property and equipment consists of the following at September 30, 2007

	Beginning Balance	Additions	Disposals	Ending Balance
Furniture and equipment	\$ 1,886,749	\$ 101,002	\$ (181,693)	\$ 1,806,058
Software	375,601	41,362	(139,876)	277,087
Leasehold improvements	245,116	10,245		255,361
Subtotal	<u>2,507,466</u>	<u>152,609</u>	<u>(321,569)</u>	<u>2,338,506</u>
Less: Accumulated depreciation/amortization	<u>1,820,861</u>	<u>256,070</u>	<u>(316,263)</u>	<u>1,760,668</u>
Capital assets (net)	<u>\$ 686,605</u>	<u>\$ (103,461)</u>	<u>\$ (5,306)</u>	<u>\$ 577,838</u>

Depreciation/amortization expense for the years ended September 30, 2008 and 2007 are \$216,190 and \$256,070, respectively.

**Legal Services Corporation
Notes to the Financial Statements
September 30, 2008 and 2007**

4. Grant Revenue

LSC was awarded grants from the U.S. Court of Veterans Appeals for the purpose of furnishing legal assistance to veterans. Grant revenues for the years ended September 30, 2008 and 2007, total \$1,223,179 and \$1,260,000, respectively.

In addition, LSC was awarded grants from the State Justice Institute, a nonprofit organization established by federal law, for the purpose of funding LSC's technology initiative grants. Grant revenues for the years ended September 30, 2008 and 2007 total \$300,000 and \$336,379, respectively.

5. Grants and Contracts Expense

Grant funding provided to the Legal Services Corporation, pursuant to Public Law 110-5, was for basic field programs. Grants and contracts expense for the years ended September 30, 2008 and 2007, consists of the following:

	<u>2008</u>	<u>2007</u>
Basic Field Programs	\$ 333,981,129	\$ 328,276,432
U.S. Court of Veterans Appeals	1,223,178	1,270,429
Technology Initiatives	2,026,014	2,446,012
Grant Recoveries	<u>(86,710)</u>	<u>(619,165)</u>
Total	<u>\$ 337,143,611</u>	<u>\$ 331,373,708</u>

6. 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

Legal Services Corporation
Notes to the Financial Statements
September 30, 2008 and 2007

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, 2008 and 2007 were \$837,743 and \$736,933, 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.

7. 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 carryout 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:

	<u>Amount</u>
September 30, 2009	\$ 1,710,000
2010	1,710,000
2011	1,710,000
2012	1,710,000
2013	<u>1,140,000</u>
Total	<u>\$ 7,980,000</u>

Rental expense for the years ended September 30, 2008 and 2007 is \$1,710,000 each year. No amounts are due to or from FoLSC at September 30, 2008 and 2007.

Sublease

During fiscal year 2005, LSC entered into a five-year sublease to lease a portion of its space, expiring in fiscal year 2010. The lease agreement provides for an annual base rent of \$53,475 with a 2% annual increase. The total minimum payments required under this sublease are as follows:

	<u>Amount</u>
2009	\$ 56,869
2010	<u>50,648</u>
Total	<u>\$ 107,517</u>

Total sublease income in fiscal year 2008 and 2007 is approximately \$55,771 and \$54,681, respectively, and is reported as a reduction of rental expense in the accompanying financial statements.

**Legal Services Corporation
Notes to the Financial Statements
September 30, 2008 and 2007**

8. 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 organizations.

Claims

LSC is defending two cases in litigation involving challenges to LSC regulations. Plaintiffs in these cases are seeking injunctive relief but no monetary damages. One case includes a perfunctory claim for attorneys' fees, but LSC believes it to be entirely without merit.

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 FY 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.

LSC is examining separate claims made by two former employees regarding their separation from LSC. To date, no litigation has been initiated. LSC believes that any cost in these matters will be insignificant to the financial statements. No funds have been recorded in the financial statements for any contingent liability in connections with these matters.

Loan Repayment Assistance Program

LSC initiated a Loan Repayment Assistance Program in 2006 that provided loans up to \$5,000 annually for participating attorneys. In 2007, loans increased to \$5,600 annually. For the years ended September 30, 2008 and 2007, participating attorneys received loans (net of repayments) totaling \$295,490 and \$348,919, respectively, and have been reflected as receivables in the accompanying statements of net assets and governmental fund balance sheets. The 2007 loans forgiven in FY 2008 totaled \$324,866 and the 2006 loans that were forgiven in 2007 were \$201,619. 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. No interest on the loans has been accrued as management has deemed these amounts to be immaterial.



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**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***

To the Inspector General and Board of Directors,
Legal Services Corporation:

We have audited the financial statements of the Legal Services Corporation as of and for the year ended September 30, 2008 and have issued our report thereon dated January 6, 2009. 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.

Internal Control Over Financial Reporting: 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 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects LSC's ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles, such that there is more than a remote likelihood that a misstatement of LSC's financial statements that is more than inconsequential will not be prevented or detected by LSC's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by LSC's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be 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 opinion. The results of our tests disclosed an instance of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Responses as item 08-1.

We noted certain matters that we reported to management of LSC in a separate letter dated January 6, 2009.

LSC's response to the finding identified in our audit is described in the accompanying Schedule of Findings and Responses. We did not audit LSC's response and accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, the Inspector General, Board of Directors, others within the organization, and Congress and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in blue ink that reads "WithumSmith+Brown, PC".

January 6, 2009

**Legal Services Corporation
Schedule of Findings and Responses
September 30, 2008**

Finding 08-1: **Classification of certain workers as independent contractors**

LSC has entered into consulting agreements with various personnel to perform services to LSC. LSC treats these workers as independent contractors, rather than employees, and therefore does not withhold or remit employer and employee's share of Social Security and Medicare taxes, and does not withhold or remit any employee income taxes. However, we noted significant internal communication to suggest that some of these workers, particularly workers in the Office of Compliance and Enforcement (OCE); should be more appropriately classified as employees for payroll tax purposes, in accordance with Internal Revenue Code Section 3121 and related laws and regulations.

LSC pays consultant fees to OCE workers totaling approximately \$140,000 to \$183,000 per year. Although LSC appears to have been internally debating this issue for a number of years, LSC has not taken appropriate steps to ensure it is in compliance with the law or can sufficiently support the position it has taken, such as obtaining an outside legal opinion or obtaining an IRS determination. Should the IRS subsequently determine that these workers should be treated as employees, LSC could be subject to back taxes, fines, penalties, and/or interest.

We recommend that LSC engage outside legal counsel to review this matter and consider obtaining a legal opinion or explore other options, such as submitting form SS-8 *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding* to the IRS, to ensure that LSC is fully compliant with this area of the Internal Revenue Code.

Management's Response

During FY 2008, LSC Management initiated a review of the proper classification of consultants that provide services to LSC, especially the consultants used by the Office of Compliance and Enforcement and the Office of Program Performance. The Office of Legal Affairs (OLA) is expected to complete an analysis of the use of consultants in early 2009. Also, on October 28, 2008, the Office of Inspector General (OIG) informed Management of their plan to conduct a review of LSC's contracting practices. Once the OLA and OIG reviews are complete, the Corporation will obtain outside counsel review and make any necessary modifications to its practices.

Auditors' Evaluation of Management's Response

Management's proposed corrective actions appear to be responsive to the finding.



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Inspector General and Board of Directors
Legal Services Corporation

In planning and performing our audit of the financial statements of Legal Services Corporation ("LSC") as of and for the year ended September 30, 2008, we considered LSC's internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on internal control.

However, during our audit we became aware of certain matters that are opportunities for strengthening internal controls and operating efficiency. The following summarizes our comments and suggestions regarding this matter. (We previously reported on LSC's compliance and internal control over financial reporting in our report dated January 6, 2009). This letter does not affect our report dated January 5, 2009, on the financial statements of the Legal Services Corporation.

We have already discussed these comments and suggestions with various LSC personnel, and we will be pleased to discuss it in further detail at your convenience, to perform any additional study of this matter, or to assist you in implementing the recommendations. The following comments relate to documentation of grantee evaluations and credit card statements:

1. Inconsistent Documentation of Grantee Evaluations

LSC has detailed policies and procedures in place for the review and evaluation of new and renewal grant award applications. These procedures include completion of a series of evaluation forms in an electronic database by evaluators in the Office of Program Performance. A proper and complete evaluation is a key control to ensure that LSC grants are awarded on a fair and competitive basis, and that LSC has determined that the grantee has sufficient capability and plans to achieve the objectives of the award.

We noted in our sample of 32 grantee evaluations that Part III of the Evaluation Form was incomplete for 7 grantees, and the recommendation section of the Evaluation Form was incomplete for 5 grantees. We discussed this issue with the Office of Program Performance, and the incomplete information was subsequently provided to us.

We recommend that the Office of Program Performance establish procedures to ensure that Evaluation Forms are properly completed before awards are made.



2. Inconsistent Documentation of Review of Credit Card Statements

LSC has policies and procedures in place for an independent review of LSC employee credit card statements prior to payment being made. This review, performed by the Accounting Manager in the Office of Finance and Administrative Services is a significant control to prevent and detect inappropriate use of the cards. Documentation of the application of the control, such as the initials on the statement of the reviewer, helps to provide evidence the control procedure has been performed to help ensure accountability over LSC funds, and is considered a sound business practice.

We noted during our review of a sample of credit card statements, that four of the 36 master statements reviewed did not contain evidence of the Accounting Manager's review.

In addition, because the Accounting Manager is also a cardholder, LSC has a procedure in place for the review of the Accounting Manager's charges by the Comptroller. We noted during our review that the Comptroller did not initial 2 of the 12 monthly statements. We did note, however, that the Comptroller initialed the check stubs for the payments related to the 2 statements that were not initialed.

We recommend that the Office of Finance and Administration continue its process of performing detailed reviews of its credit card activity and document its review by initialing the actual statements.

This report is intended solely for the information and use of the Inspector General, the Board of Directors and Management and others within the organization.

A handwritten signature in cursive script that reads "William Smith + Brown, PC".

January 6, 2009