




Office of Inspector General  
Legal Services Corporation

Inspector General  
Jeffrey E. Schanz

3333 K Street, NW, 3rd Floor  
Washington, DC 20007-3558  
202.295.1660 (p) 202.337.6616 (f)  
www.oig.lsc.gov

## MEMORANDUM

**TO:** Board of Directors  
Legal Services Corporation

**FROM:** Jeffrey E. Schanz  
Inspector General 

**SUBJECT:** Transmittal of FY 2009 Financial Statement Audit Report

**DATE:** January 21, 2010

---

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, 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 Report by TCBA stated that LSC's financial statements present fairly, in all material respects, the financial position of LSC as of September 30, 2009, and the changes in its net assets and its cash flows for the year 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 report 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 report, dated January 13, 2010, along with the conclusions expressed in the report.

Attachment

cc: Victor Fortuno  
Interim President

Charles Jeffress  
Chief Administrative Officer



**THOMPSON, COBB, BAZILIO & ASSOCIATES, PC**  
*Certified Public Accountants and Management, Systems, and Financial Consultants*

---

■ Main Office:  
1101 15th Street, N.W.  
Suite 400  
Washington, DC 20005  
(202) 737-3300  
(202) 737-2684 Fax

□ Regional Office:  
Two Penn Center  
Suite 200  
Philadelphia, PA 19102  
(215) 854-6300  
(215) 569-0216 Fax

□ Regional Office:  
21250 Hawthorne Boulevard  
Suite 150  
Torrance, CA 90503  
(310) 792-4640  
(310) 792-4140 Fax

**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, 2009 and have issued our report thereon dated January 13, 2010. 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 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 13, 2010.

This report is intended solely for the information and use of management, the Audit Committee of the Board of Directors, the LSC 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 13, 2010

Thompson, Cobb, Bazilio & Associates, PC



## Legal Services Corporation

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

# TCBA

**THOMPSON, COBB, BAZILIO & ASSOCIATES, PC**  
*Certified Public Accountants & Management, Systems and Financial Consultants*

1101 15th Street, NW Suite 400 Washington, DC 20005  
PH 202.737.3300 ▪ FX 202.737.2684 ▪ [www.tcba.com](http://www.tcba.com)

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

**TABLE OF CONTENTS**

	<b><u>PAGE</u></b>
INDEPENDENT AUDITOR'S REPORT .....	1
<b>FINANCIAL STATEMENTS</b>	
STATEMENT OF FINANCIAL POSITION .....	3
STATEMENT OF ACTIVITIES .....	4
STATEMENT OF CASH FLOWS .....	5
NOTES TO FINANCIAL STATEMENTS .....	6
MANAGEMENT'S DISCUSSION AND ANALYSIS .....	16

**THOMPSON, COBB, BAZILIO & ASSOCIATES, PC**  
*Certified Public Accountants and Management, Systems, and Financial Consultants*

---

■ Main Office:

1101 15th Street, N.W.  
Suite 400  
Washington, DC 20005  
(202) 737-3300  
(202) 737-2684 Fax

□ Regional Office:

Two Penn Center  
Suite 200  
Philadelphia, PA 19102  
(215) 854-6300  
(215) 569-0216 Fax

□ Regional Office:

21250 Hawthorne Boulevard  
Suite 150  
Torrance, CA 90503  
(310) 792-4640  
(310) 792-4140 Fax

## INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying statement of financial position of Legal Services Corporation ("LSC") as of September 30, 2009, and the related statements of activities and cash flows for the year 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 audit.

We conducted our audit 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 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 audit provides 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, 2009, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was 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 16 to 30 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 13, 2010 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  
January 13, 2010

Thompson, Cobb, Bazilio & Associates, PC

**LEGAL SERVICES CORPORATION**  
**STATEMENT OF FINANCIAL POSITION**  
**SEPTEMBER 30, 2009**

**ASSETS**

Cash and cash equivalents	\$ 77,940,065
Accounts receivable	625,342
Prepaid expenses and deposits	178,663
Fixed assets, net	<u>395,244</u>
 Total assets	 <u><u>\$ 79,139,314</u></u>

**LIABILITIES**

Grants and contracts payable	\$ 68,335,697
Accounts payable	302,383
Accrued vacation and other liabilities	1,236,290
Deferred revenue	<u>2,800,129</u>
 Total liabilities	 <u>72,674,499</u>

**NET ASSETS**

Unrestricted net assets:	
Designated	835,863
Undesignated	5,233,708
Net investment in fixed assets	<u>395,244</u>
 Total unrestricted net assets	 <u>6,464,815</u>
 Total liabilities and unrestricted net assets	 <u><u>\$ 79,139,314</u></u>

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

**LEGAL SERVICES CORPORATION  
STATEMENT OF ACTIVITIES  
YEAR ENDED SEPTEMBER 30, 2009**

<b>SUPPORT AND REVENUE</b>	
Federal appropriations	\$ 390,000,000
Grant revenue	2,034,086
Interest	39,379
Other income	6,598
Change in deferred revenue	<u>(1,370,641)</u>
 Total support and revenue	 <u>390,709,422</u>
 <b>EXPENSES</b>	
Program activities:	
Grants, contracts and reimbursable expenses	<u>371,257,115</u>
Supporting activities:	
Management and grants oversight	13,845,616
Office of Inspector General	3,270,879
Herbert S. Garten Loan Repayment Assistance Program	<u>279,400</u>
 Total supporting activities	 <u>17,395,895</u>
 Total expenses	 <u>388,653,010</u>
 Change in net assets	 2,056,412
Unrestricted net assets, beginning of year	4,408,403
Unrestricted net assets, end of year	<u>\$ 6,464,815</u>

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

**LEGAL SERVICES CORPORATION  
STATEMENT OF CASH FLOWS  
YEAR ENDED SEPTEMBER 30, 2009**

**CASH FLOWS FROM OPERATING ACTIVITIES**

Change in net assets	\$ 2,056,412
Adjustment to reconcile change in net assets to net cash and cash equivalents provided by operating activities:	
Depreciation and amortization	215,810
Loss on disposal of assets	583
Increase in accounts receivable	(31,106)
Increase in LRAP receivable	(249,480)
Decrease in prepaid expenses and deposits	53,560
Increase in grants and contracts payable	6,822,430
Increase in vouchers payable	76,049
Increase in salaries payable and other payroll liabilities	270,493
Increase in deferred revenue	1,366,555
Net cash and cash equivalents provided by operating activities	10,581,306

**CASH FLOWS FROM INVESTING ACTIVITIES**

Purchases of fixed assets	(93,347)
Net increase in cash and cash equivalents	10,487,959
Cash and cash equivalents, beginning of year	67,452,106
Cash and cash equivalents, ending of year	\$ 77,940,065

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

**LEGAL SERVICES CORPORATION  
NOTES TO FINANCIAL STATEMENTS  
SEPTEMBER 30, 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.

As discussed in more detail in Note 12, LSC has elected to follow 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 Accounting Standards Codification (ASC) 958, *Not-for-Profit Entities*. Under 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 restricted or permanently restricted 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.

**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

**LEGAL SERVICES CORPORATION  
NOTES TO FINANCIAL STATEMENTS  
SEPTEMBER 30, 2009**

**NOTE 1      SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Support and Revenue (Continued)**

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.

**LEGAL SERVICES CORPORATION  
NOTES TO FINANCIAL STATEMENTS  
SEPTEMBER 30, 2009**

**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, 2009 consisted of the following:

Cash in U.S. Treasury	\$ 41,663,198
Cash in financial institution	36,274,867
Petty cash	<u>2,000</u>
Total cash and cash equivalents	<u><u>\$ 77,940,065</u></u>

**NOTE 3 FIXED ASSETS**

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

Furniture	\$ 1,824,982
Software	341,201
Leasehold improvements	<u>321,687</u>
Subtotal	2,487,870
Less: accumulated depreciation/ amortization	<u>2,092,626</u>
Fixed assets, net	<u><u>\$ 395,244</u></u>

**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.

Grant revenue for the year ended September 30, 2009 consisted of the following:

U.S. Court of Veterans Appeals grant	\$ 1,700,000
Veterans reimbursable expenses	4,086
State Justice Institute	<u>330,000</u>
Total grant revenue	<u><u>\$ 2,034,086</u></u>

**LEGAL SERVICES CORPORATION  
NOTES TO FINANCIAL STATEMENTS  
SEPTEMBER 30, 2009**

**NOTE 5 GRANT AND CONTRACT EXPENSES**

Grant and contract expenses in fiscal year 2009 were as follows:

Basic Field Programs	\$ 365,745,172
U.S. Court of Veterans Appeals Funds	1,704,086
Technology Initiatives	3,705,628
Grants From Other Funds	283,734
Grant Recoveries	<u>(181,505)</u>
 Total grant and contract expenses	 <u><u>\$ 371,257,115</u></u>

**NOTE 6 MANAGEMENT AND GRANTS OVERSIGHT**

Management and grants oversight expenses in fiscal year 2009 were as follows:

Compensation and benefits	\$ 9,917,209
Temporary employee pay	67,549
Consulting	686,858
Travel and transportation	494,432
Communications	132,567
Occupancy cost	1,654,289
Printing and reproduction	50,659
Other operating expenses	625,184
Capital expenditures	<u>61,435</u>
 Total	 13,690,182
 Depreciation and amortization	 215,810
Loss on disposal of assets	584
Less: capitalized assets	<u>(60,960)</u>
 Total management and grant oversight expenses	 <u><u>\$ 13,845,616</u></u>



**LEGAL SERVICES CORPORATION  
NOTES TO FINANCIAL STATEMENTS  
SEPTEMBER 30, 2009**

**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 year ended September 30, 2009, participating attorneys received loans totaling \$569,023, which have been reflected as receivables.

The loans forgiven in fiscal year 2009 totaled \$279,400. 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 in fiscal year 2009 were as follows:

Compensation and benefits	\$ 2,977,165
Temporary employee pay	9,531
Consulting	65,570
Travel and transportation	145,626
Communications	22,138
Printing and reproduction	3,109
Other operating expenses	47,740
Capital expenditures	<u>32,387</u>
 Total	 3,303,266
 Less: capitalized assets	 <u>(32,387)</u>
 Total Office of Inspector General expenses	 <u><u>\$ 3,270,879</u></u>

**LEGAL SERVICES CORPORATION  
NOTES TO FINANCIAL STATEMENTS  
SEPTEMBER 30, 2009**

**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 employees salary regardless of their participation to the maximum permitted under federal income tax rules

LSC’s contributions to these plans for the year ended September 30, 2009 were \$858,469. 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.

**LEGAL SERVICES CORPORATION  
NOTES TO FINANCIAL STATEMENTS  
SEPTEMBER 30, 2009**

**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:

<u>September 30,</u>	<u>Amount</u>
2010	\$ 1,710,000
2011	1,710,000
2012	1,710,000
2013	1,140,000
Total	\$ 6,270,000

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

**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 \$53,415 with a 2% annual increase. The total minimum payments required under this sublease are as follows:

	<u>Amount</u>
2010	\$ 50,648

Total sublease income in fiscal year 2009 was approximately \$57,883 and is reported as a reduction of rental expense in the accompanying financial statements.

**LEGAL SERVICES CORPORATION  
NOTES TO FINANCIAL STATEMENTS  
SEPTEMBER 30, 2009**

**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.

**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 as to former President Barnett and LSC, neither of whom play any role in a given LSC grantee's decision regarding the acceptance of cases within the scope of LSC's rules and restrictions. No outside counsel has been retained and no attorneys' fees or costs have been incurred.

**NOTE 12 PRIOR YEAR RESTATEMENT**

LSC has followed generally accepted accounting principles (GAAP) for state and local governments since 2002. Prior to 2002, LSC followed GAAP for nongovernmental entities promulgated by the Financial Accounting Standards Board (FASB). The Governmental Accounting Standards Board (GASB) is the source of GAAP for state and local governments. As LSC is not a part of a state or local government unit and does not meet GASB criteria, LSC elected to revert to GAAP for nongovernmental entities. Beginning net assets have been restated to conform with accounting principles generally accepted in the United States of

**LEGAL SERVICES CORPORATION  
NOTES TO FINANCIAL STATEMENTS  
SEPTEMBER 30, 2009**

**NOTE 12 PRIOR YEAR RESTATEMENT (CONTINUED)**

America for not-for-profit organizations. Net assets at the beginning of the year were restated as follows:

	<b>As Previously Reported</b>	<b>As Restated</b>
Restricted net assets	\$ 3,890,113	\$ -
Unrestricted net assets - designated	\$ -	\$ 1,318,805
Unrestricted net assets - undesignated	\$ -	\$ 2,571,308

**NOTE 13 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 is required for the years ended September 30, 2009 and 2008 as LSC had no net unrelated business income.

In December 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) FIN 48-3, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises*. FSP FIN 48-3 permits an entity within its scope to defer the effective date of FASB Interpretation No. 48 (Interpretation No. 48), *Accounting for Uncertainty in Income Taxes*, to its annual financial statements for fiscal years beginning after December 15, 2008. LSC has elected to defer the application of Interpretation No. 48 for the year ended September 30, 2009. LSC evaluates its uncertain tax positions using the provision of FASB Statement No. 5, *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, 2009.

**NOTE 14 SUBSEQUENT EVENTS**

In preparing these financial statements, LSC has evaluated events and transactions for potential recognition or disclosure through January 13, 2010, the date the financial statements were issued.

**LEGAL SERVICES CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2009**

**NOTE 14      SUBSEQUENT EVENTS (Continued)**

In December 2009, the House and Senate approved a consolidated appropriations bill that included \$420 million in funding for LSC. President Obama signed the appropriations bill into law on December 16, 2009.

**LEGAL SERVICES CORPORATION  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
FOR THE YEAR ENDED SEPTEMBER 30, 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 funds 137 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 that the programs provide high-quality legal services and comply with congressional restrictions, LSC rules and regulations.

LSC's largest offices provide oversight of LSC grantees:

- The Office of Program Performance 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 reviews grantee compliance with the LSC Act, with congressional restrictions on the use of 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.

In addition to the above offices, LSC has a statutorily independent Office of Inspector General (OIG), established in 1988, to conduct and supervise audits, investigations and reviews to detect and prevent fraud and abuse and to assist management in identifying ways to promote efficiency and effectiveness in LSC operations, and programs. The OIG provides the LSC and Congress with independent and objective assessments of programs, activities, and related opportunities to be more successful. 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

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

audits performed by independent public accountants. It also specifies the OIG's authority to conduct its own reviews of grantee compliance.

**Overview of Financial Statements**

The annual financial report presents LSC's finance 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 fiscal year 2009 and fiscal year 2008, and an overview of the fiscal year 2009 operating budget experience. Notes to the financial statements provide further details on specific items contained in the tables.

**Financial Highlights**

LSC receives its financial support from a congressional 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 helps support LSC's Technology Initiative Grants. Any remaining funds from one year's budget are included in the next year's budget to support the next year's activities.

For fiscal year 2009, LSC operated under a Continuing Resolution at 2008 funding levels until March 12, 2009. President Obama signed into law an appropriation of \$390 million, an increase of approximately \$40 million from fiscal year 2008. Most of the fiscal year 2009 appropriation, \$365.8 million, was provided by the Congress for Basic Field Grants for the provision of civil legal assistance to low-income Americans. The follow table shows the critical elements of the budget and their breakdown:



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

**Table 1**

(1)	(2)	(3)	(4)
Fiscal Year 2009 Appropriation	Fiscal Year 2008 Carryover	Court of Veterans Appeals, State Justice Institute and Adjustments	Fiscal Year 2009 Consolidated Operating Budget
\$ 365,800,000	\$ 1,045,585	-	\$ 366,845,585
-	4,398	1,700,000	1,704,398
-	934,673	-	934,673
<u>3,000,000</u>	<u>383,591</u>	<u>330,000</u>	<u>3,713,591</u>
368,800,000	2,368,247	2,030,000	373,198,247
16,000,000	1,646,898	(400,000)	17,246,898
1,000,000	470,842	500,000	1,970,842
<u>4,200,000</u>	<u>837,699</u>	<u>-</u>	<u>5,037,699</u>
<u>\$ 390,000,000</u>	<u>\$ 5,323,686</u>	<u>\$ 2,130,000</u>	<u>\$ 397,453,686</u>

I. DELIVERY OF LEGAL ASSISTANCE

1. Basic Field Programs
2. U.S. Court of Veterans Appeals Funds
3. Grants From Other Funds
4. Technology Initiatives

DELIVERY OF LEGAL ASSISTANCE TOTALS

II. MANAGEMENT & GRANTS OVERSIGHT

III. HERBERT S. GARTEN  
LOAN REPAYMENT ASSISTANCE PROGRAM

IV. INSPECTOR GENERAL

TOTAL BUDGET

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

The next two tables show abbreviated Statements of Financial Position and Statements of Activities for the two years.

**Table 2  
Statements of Financial Position**

	<b>September 30</b>	
	<b><u>2009</u></b>	<b><u>2008</u></b>
<b>Assets</b>		
Total current assets and other assets	\$ 78,744,070	\$ 68,029,086
Net property and equipment	<u>395,244</u>	<u>518,290</u>
<b>Total assets</b>	<b><u>\$ 79,139,314</u></b>	<b><u>\$ 68,547,376</u></b>
<b>Liabilities</b>		
Grants and contracts payable	\$ 68,335,697	\$ 61,513,267
Other liabilities	1,538,673	1,192,131
Deferred revenue	<u>2,800,129</u>	<u>1,433,575</u>
<b>Total liabilities</b>	<b><u>72,674,499</u></b>	<b><u>64,138,973</u></b>
<b>Net Assets</b>		
Unrestricted net assets:		
Designated	835,863	1,318,805
Undesignated	5,233,708	2,571,308
Net investment in fixed assets	<u>395,244</u>	<u>518,290</u>
<b>Total net assets</b>	<b><u>6,464,815</u></b>	<b><u>4,408,403</u></b>
<b>Total liabilities and net assets</b>	<b><u>\$ 79,139,314</u></b>	<b><u>\$ 68,547,376</u></b>

Operations in 2009 yielded an increase to net assets in the amount of \$2,179,458. Fixed assets, which are the net of purchases minus depreciation, resulted in a decrease of \$123,046. The overall change in net assets as shown in the Statement of Activities was \$2,056,412 for the year ended September 30, 2009.

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

**Table 3  
Statements of Activities**

	<b>September 30</b>	
	<u><b>2009</b></u>	<u><b>2008</b></u>
<b>Revenue</b>		
Federal appropriations	\$ 390,000,000	\$ 350,490,000
Grant revenue	2,059,086	1,523,179
<b>General revenues</b>		
Change in deferred revenue	(1,395,641)	1,217,143
Contributed services	-	163,571
Interest and other income	45,977	684,796
<b>Total revenue</b>	<u>390,709,422</u>	<u>354,078,689</u>
<b>Expenses</b>		
Program activities	371,257,115	337,143,612
Supporting activities	17,395,895	17,513,236
<b>Total expenses</b>	<u>388,653,010</u>	<u>354,656,848</u>
Change in net assets	2,056,412	(578,159)
Net assets, beginning of year	4,408,403	4,986,562
<b>Net assets end of year</b>	<u>\$ 6,464,815</u>	<u>\$ 4,408,403</u>

**Fiscal Year 2009 MGO Budgetary Analysis and Activity Description**

The primary reason for the net asset increase was because of the timing of this year's appropriation. With the appropriation signed into law in March, Management & Grants Oversight (MGO) and Office of Inspector General could not effectively spend the available funding. MGO had received essentially flat funding in prior years and grew to \$16 million in fiscal year 2009, rising from \$12.5 million in fiscal year 2008. MGO was previously called Management & Administration. The fiscal year 2009 funding permitted LSC to return \$500,000 to the Herbert S. Garten Loan Repayment Assistance Program (LRAP), which helps LSC-funded programs recruit and retain talented attorneys. LSC reprogrammed \$500,000 from LRAP to MGO in fiscal year 2008 to avoid a reduction-in-force because of a funding delay.

LSC's 2009 budget included funding to engage outside legal counsel to review the classification of certain workers as independent contractors rather than as temporary employees. After that review, LSC strengthened internal controls over consultant contracts. The revised contracting procedures were submitted to the OIG for review on September 16, 2009.

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

**Improving Grantee Oversight**

In fiscal year 2009, LSC created advisory groups of LSC and grantee staff on local board governance, on fiscal practices and on private attorney involvement in order to identify areas for improvement. To follow up on the work of those groups, LSC anticipates in fiscal year 2010 initiating specialized training for grantee boards and staffs. Under the initiative, LSC will establish a training unit to develop web-based and in-person training.

Grants oversight is a vital function of LSC. The LSC Board of Directors authorized the creation of new positions in fiscal year 2009 to enhance oversight of grantees. Hiring for the new positions, part of a two-year staffing plan, began in 2009.

Tables 4 present the final budgets for MGO for fiscal years 2009 and 2008.

**Table 4  
Management and Grants Oversight  
Operating Budget for 2009 and 2008**

<u>Budget Category</u>	<u>2009</u>	<u>2008</u>
Compensation and benefits	\$ 11,238,200	\$ 10,225,310
Temporary employee pay	89,150	82,075
Consulting	1,093,050	1,074,175
Travel and transportation	924,750	709,950
Communication	184,350	152,940
Occupancy cost	1,681,800	1,678,375
Printing and reproduction	113,800	113,100
Other operating expenses	1,719,298	1,188,025
Capital expenditures	202,500	151,400
Total	<u>\$ 17,246,898</u>	<u>\$ 15,375,350</u>

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

Tables 5 present the final expenses for MGO for fiscal years 2009 and 2008.

**Table 5  
Management and Grants Oversight  
Operating Expenses for 2009 and 2008**

<u>Budget Category</u>	<u>2009</u>	<u>2008</u>
Compensation and benefits	\$ 9,917,209	\$ 9,901,937
Temporary employee pay	67,549	69,121
Consulting	686,858	1,029,113
Travel and transportation	494,432	627,916
Communication	132,567	120,701
Occupancy cost	1,654,289	1,661,722
Printing and reproduction	50,659	64,986
Other operating expenses	625,184	601,357
Capital expenditures	61,435	74,965
	<hr/>	<hr/>
Subtotal	13,690,182	14,151,818
Depreciation and amortization	215,810	216,190
Loss on disposal of assets	584	1,139
Less: capitalized assets	(60,960)	(74,965)
	<hr/>	<hr/>
Total	<u>\$ 13,845,616</u>	<u>\$ 14,294,182</u>

From the budget table and the expense table, you will note that MGO had a higher budget in 2009, yet expenses were less than in 2008. The combination of a higher budget and less expenses resulted in an increase in net assets in fiscal year 2009.

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

**Fiscal Year 2009 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 fiscal year 2009, Jeffrey E. Schanz served as the Inspector General for the LSC.

The fiscal year 2009 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 (the last three of series of eight audit reports were issued during fiscal year 2009);
- Performed grantee audits of Legal Services of Greater Miami and Legal Aid of Northwest Texas;
- Expanded reviews of 137 grantee audit reports with referral of all significant findings to LSC management for resolution;
- Several audit quality reviews of the IPAs' grant recipient audits;
- Investigations related to compliance matters and theft or embezzlement of grantee funds;
- Fraud vulnerability briefings, assessments and reviews;
- A fraud alert to grantee directors highlighting possible vulnerabilities to embezzlement; and
- Operating 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 an LSC grantee's violations of Congressional restrictions.

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

Internally focused projects, reviewing selected LSC management operations and activities, which included:

- Timely responses to several Congressional inquiries;
- Audit of Legal Services Corporation's Consultant Contracts;
- Oversight of the fiscal year 2008 LSC corporate audit;
- Board Advisory on Sunshine Act Compliance;
- Two Management Information Memoranda regarding grant recipient oversight and compliance with LSC and Internal Revenue Services regulations; and,
- Commented on significant LSC proposed legislation, regulations and policy initiatives including the Civil Access to Justice Act of 2009, Inspector General Reform Act of 2008, and rulemaking regarding lesser or intermediate sanctions;
- Participated as a full member of the Council of Inspectors General for Integrity and Efficiency; and
- Developed and maintained an online Board Reference Library as an OIG reference tool for the Board and as a training/orientation aid for new members.

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

Tables 6 present the final budgets for OIG for fiscal years 2009 and 2008.

**Table 6  
Office of Inspector General  
Operating Budgets for September 2009 and 2008**

<b>Budget Category</b>	<b>2009</b>	<b>2008</b>
Compensation and benefits	\$ 3,263,301	\$ 3,094,000
Temporary employee pay	50,624	25,000
Consulting	393,932	327,701
Travel and transportation	251,917	178,000
Communication	38,363	24,600
Occupancy cost	1,000	1,000
Printing and reproduction	6,034	4,200
Other operating expenses	968,528	62,200
Capital expenditures	64,000	98,000
<b>Total</b>	<b>\$ 5,037,699</b>	<b>\$ 3,814,701</b>



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

Tables 7 present the final expenses for OIG for fiscal years 2009 and 2008.

**Table 7  
Office of Inspector General  
Operating Expenses for 2009 and 2008**

<u>Budget Category</u>	<u>2009</u>	<u>2008</u>
Compensation and benefits	\$ 2,977,165	\$ 2,674,713
Temporary employee pay	9,531	-
Consulting	65,570	39,167
Travel and transportation	145,626	140,716
Communications	22,138	19,590
Printing and reproduction	3,109	2,286
Other operating expenses	47,740	17,716
Capital expenditures	32,387	82,815
 Subtotal	 3,303,266	 2,977,003
Less: capitalized assets	(32,387)	(82,815)
Total	<u>\$ 3,270,879</u>	<u>\$ 2,894,188</u>

From the budget table and the expense table, you will note that OIG had a higher budget in 2009, and expenses increased in 2009. The OIG is taking a fiscally prudent approach to expending the increased funding by making incremental increases in OIG operations. During fiscal year 2009, the OIG filled three new positions, but two positions remain open resulting in variances in the compensation and benefits categories. After the funding increase, the OIG completed the process for competitively awarding an information technology (IT) services contract to upgrade aging IT systems, improve records management and enhance the OIG's ability to use grantee information in work planning and operations. The larger pieces of the IT work will initiate in fiscal years 2010 and 2011, resulting in fiscal year 2009 carryover in the consulting and other operating expense categories. However, the majority of the carryover in the other operating expenditure category is a result of a contingency fund in the amount of \$890,000. This fund will be expended in fiscal years 2010 and 2011, as the OIG spends down its carryover position in a controlled manner. Additionally, carryover in the travel expenditure category resulted from efficient travel visiting multiple organizations in a single trip and shifting workload demands during the year.

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

**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. Three out of four of the clients served by LSC-funded programs are women—many of whom are struggling to keep their children safe and their families together. Persons eligible for LSC-funded services are at or below 125 percent of the federal poverty guidelines; in 2009, that was an income of \$27,563 for a family of four.

Many LSC-funded programs report a rise in requests for legal services because of the recession. The loss of jobs, loss of homes and loss of health care caused by the recession and the foreclosure crisis have contributed to the demand by existing clients and new applicants for legal help to meet their basic needs.

Although economists and analysts reported that the recession appeared to be ending in late 2009, federal government projections show that unemployment will remain high, peaking at a rate above 10 percent before declining in 2010. If that occurs, the number of people eligible for legal services will increase.

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 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 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.

Technology plays an increasingly vital role in the delivery of legal services, and LSC’s Technology Initiative Grants (TIG) program encourages grantees to pilot new methods for serving clients and unrepresented litigants. TIG supports state and local projects, including initiatives with state courts, which can be replicated in other areas. In rural areas, technology can help deliver services more efficiently.

Closing the justice gap will require a multifaceted approach that will require action by federal, state and local governments, private funders, the organized bar, individual lawyers and others. It means providing more *pro bono* assistance, developing effective *pro se* initiatives, securing

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

additional financial assistance from state and local governments and private funders, and enhancing strategic partnerships and collaborations that help meet the civil legal needs of low-income Americans. As charged by the Congress, LSC must take the lead in ensuring equal access to justice for all Americans.

**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. LSC approved three emergency grants and special needs grant in 2009: one to Capital Area Legal Services Corporation, based in Baton Rouge, Louisiana; the second to Arcadian Legal Services in Lafayette, Louisiana; and the third to Lone Star Legal Aid, based in Houston. Each of these grants were given to help defray costs of providing legal services to survivors of hurricanes Gustav and Ike.

The special needs grant was awarded to Legal Aid of Wyoming Inc. to provide transition funding for the interim provider to continue services to clients in December 2008 while a competition was completed for a new grantee.

**Fixed Assets and Long-Term Debt**

Categories of fixed assets are reported in Table 8 for the fiscal years ended September 30, 2009 and 2008, respectively. There is no short or long-term debt activity relating to fixed assets.

**Table 8  
Fixed Assets**

<b>Fiscal Year 2009</b>	<b>Beginning Balance</b>	<b>Additions</b>	<b>Disposals</b>	<b>Ending Balance</b>
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
Subtotal	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	<u>\$ 518,290</u>	<u>\$ (122,463)</u>	<u>\$ (583)</u>	<u>\$ 395,244</u>

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

<b>Fiscal Year 2008</b>	<b>Beginning Balance</b>	<b>Additions</b>	<b>Disposals</b>	<b>Ending Balance</b>
Furniture	\$ 1,806,059	\$ 43,342	\$ (65,820)	\$ 1,783,581
Software	277,087	49,262	-	326,349
Leasehold improvements	255,361	65,176	-	320,537
Subtotal	2,338,507	157,780	(65,820)	2,430,467
Less: accumulated depreciation/ amortization	1,760,668	216,190	(64,681)	1,912,177
Total fixed assets, net	<u>\$ 577,839</u>	<u>\$ (58,410)</u>	<u>\$ (1,139)</u>	<u>\$ 518,290</u>

**Major Challenges**

The nonprofit programs funded by LSC serve only half of those seeking legal assistance and often must settle for providing many applicants with less than full representation, as documented in the 2009 justice gap report.

This is a daunting challenge, and the need for basic legal services is large and growing.

About 54 million Americans-including 18.5 million children-are eligible for LSC-funded services, according to 2008 U.S. Census Bureau data, the most recent available. The 2008 total is the highest number of people eligible for civil legal assistance in LSC history. The 2008 poverty figures reflect the initial effects of the recession, and portend even larger increases for 2009 because of high unemployment rates.

Labor market conditions for much of 2009 indicated to some economists that many workers will not be called back to work once the economy improves. The longer people are out of work, the more likely they are to spend down savings or lose their homes to foreclosure. Many LSC-funded programs reported a rise in requests for help from low-income Americans facing foreclosure actions. In the spring of 2009, because of a lack of resources, LSC-funded programs reported that they were turning away two foreclosure assistance requests for every case they accepted. Some LSC-funded programs also reported high demand for assistance with basic needs related to health, shelter, safety, access to education and employment.

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. IOLTA grants-the second-largest single source of funding for LSC programs-declined significantly in 2009 because the Federal Reserve had dropped the short-term interest rate to

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

virtually zero. The impact of the IOLTA erosion varies state by state, but projections suggest that numerous legal aid programs will receive less IOLTA funding in 2009 and 2010.

LSC grants in 2008 represented about 40 percent of the total resources that LSC grantees receive. If state funding, charitable contributions and IOLTA revenue drops significantly by the end of 2009 or in 2010, 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.

Members of Congress have introduced legislation in the House and in the Senate that would reauthorize LSC and would recommend an annual funding level of \$750 million. The bills also lift certain restrictions on how grantees use their LSC and federal funds; if enacted, LSC staff would develop new regulatory and legal guidance for grantees.

An additional challenge facing LSC in 2010 is the turnover in corporate leadership. As of December 21, 2009, President Obama has named nine new members for the 11 member LSC Board of Directors; six of them represent a new majority for the Board. The new Board is expected to select a new president for LSC, as the contract of the current president, Helaine M. Barnett, expires December 31, 2009.

LSC also will be negotiating its first union contract. Professional employees in the offices of Program Performance and Compliance and Enforcement voted in September 2009 to be represented by the International Federation of Technical and Professional Engineers.

In pursuit of the OIG Strategic Plan's goals and objectives, the OIG will perform audit, evaluation, and investigative fact-finding activities in accord 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 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.

Because Congress had not approved the fiscal year 2010 appropriation for LSC by October 1, 2009, LSC began the new fiscal year operating at fiscal year 2009 funding levels, under a Continuing Resolution signed into law on September 30, 2009.

In December 2009, the House and Senate approved a consolidated appropriations bill that included \$420 million in funding for LSC. President Obama signed the appropriations bill into law on December 16, 2009.





## Legal Services Corporation

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

# TCBA

**THOMPSON, COBB, BAZILIO & ASSOCIATES, PC**  
*Certified Public Accountants & Management, Systems and Financial Consultants*

1101 15th Street, NW Suite 400 Washington, DC 20005  
PH 202.737.3300 ▪ FX 202.737.2684 ▪ [www.tcba.com](http://www.tcba.com)

**Legal Services Corporation  
Report of Deficiencies in Internal  
Control Over Financial Reporting and  
Other Matters**

**TABLE OF CONTENTS**

	<u>PAGE</u>
Report on Deficiencies in Internal Control Over Financial Reporting and Other Matters .....	1
Appendix A Deficiencies in Internal Control Over Financial Reporting .....	3
Appendix B Other Matters.....	7



**THOMPSON, COBB, BAZILIO & ASSOCIATES, PC**  
*Certified Public Accountants and Management, Systems, and Financial Consultants*

---

■ Main Office:

1101 15th Street, N.W.  
Suite 400  
Washington, DC 20005  
(202) 737-3300  
(202) 737-2684 Fax

□ Regional Office:

Two Penn Center  
Suite 200  
Philadelphia, PA 19102  
(215) 854-6300  
(215) 569-0216 Fax

□ Regional Office:

21250 Hawthorne Boulevard  
Suite 150  
Torrance, CA 90503  
(310) 792-4640  
(310) 792-4140 Fax

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

In planning and performing our audit of the financial statements of the Legal Services Corporation (“LSC”) for the year ended September 30, 2009, we considered its internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control over financial reporting.

In connection with our audit of the financial statements of LSC as of and for the year ended September 30, 2009, we identified deficiencies in internal control over financial reporting (control deficiencies), and certain matters that are opportunities for strengthening internal controls and operating efficiency.

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.

The control deficiencies identified that did not constitute significant deficiencies or material weaknesses are described in Appendix A. Those matters identified to strengthen internal controls and operating efficiency are identified in Appendix B.

We previously reported on LSC’s internal control over financial reporting and on compliance and other matters in our report dated January 13, 2010. This letter does not affect our report, dated January 13, 2010, on the financial statements of LSC.

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 13, 2010

Thompson, Cobb, Bazilio & Associates, PC

## **APPENDIX A**

# **Deficiencies in Internal Control Over Financial Reporting**

**APPENDIX A**  
**Deficiencies in Internal Control Over Financial Reporting**

**1. Delays in Reports Issued by Office of Compliance and Enforcement**

*Condition:* We selected nine site visits and reviewed the related workpapers and reports completed in fiscal year 2009. Our sample included visits that did not exceed one week. We noted that the final reports were not issued timely. For example, one out of nine reports was issued 289 calendar days after the completion of fieldwork.

*Criteria:* The Legal Services Corporation Act 42 U.S.C. §2996 et. Seq. (2009) requires LSC to monitor and evaluate and provide for independent evaluations of programs to insure that the provisions of the Act and the bylaws of the Corporation and applicable rules, regulations, and guidelines promulgated are followed. According to the Procedures Manual (2009 Edition) of the Office of Compliance and Enforcement (OCE), OCE's mission is to "review recipient compliance with the LSC Act, regulations, instructions, guidelines and grant assurances".

OCE performs annual risk assessments of grantees and conducts site visits in order to review grantees' compliance with LSC rules and regulations and grant award conditions. The OCE Procedures Manual outlines all the major rules and regulations grantees are subject to, types of OCE reviews, the checklists reviewers are required to use during their fieldwork, and the timeline for issuance of reports. The manual states that:

1. Individual reports must be submitted within 10 working days of the team member's return to the office;
2. Draft team reports for one-week trips must be submitted to the Director within 60 calendar days of the team leader's return to the office;
3. Draft team reports for two-week trips must be submitted to the Director within 90 calendar days;
4. Reports, after review by the Director, must be released to the grantee with a cover letter allowing a minimum of 30 calendar days for comments and to the Vice President of Program and Compliance and the Director of Office of Program Performance; and
5. Once the grantee's comments are received, the leader is to incorporate the comments in the final report within 14 calendar days and submit the final report to the Director and Deputy Director for release.

*Effect:* Delays in communication of the findings can result in the grantees' control weaknesses and non-compliance issues not being remedied timely. In addition, delays in issuing reports for site visits conducted by OCE may result in the Board of Directors and other decision makers not being provided with timely

**APPENDIX A**  
**Deficiencies in Internal Control Over Financial Reporting**

information about grantee performance which is critical information in making funding, partnership and strategic decisions.

*Cause:* Delays in issuance of the reports were due to:

- 1) Grantee requests for extension of time in which to submit comments to Draft Report;
- 2) Grantee requests for OCE technical assistance in drafting policies and procedures in response to required corrective actions. OCE's ongoing input on corrective action items impacts the release of the Final Report;
- 3) Need for OCE to request opinions from LSC's Office of Legal Affairs (OLA) regarding issues discovered onsite or via grantee comments to the Draft Report, as well as need for OLA review of all Draft and Final Reports involving Program Integrity issues prior to issuance; and
- 4) OCE staff work and vacation schedules.

*Recommendation:* We recommend that OCE implement procedures to ensure reports are issued more timely.

*Management Response:* Management has reviewed the policies and procedures for the issuance of OCE reports, and will revise them to include contingencies such as requests for extensions and OLA opinions noted above.

**2. Non-compliance with Administrative Manual in Hiring Consultants**

*Condition:* During our review of the engagement and payment process for consultants, we noted that the Contract Approval Forms and Contract Approval Cover Sheets were not used as required by the LSC Administrative Manual, and there were no evidence of sign-offs by the Office of Legal Affairs, which was required on the Contract Approval Cover Sheet. LSC issued a revised Administrative Manual effective October 1, 2009. The procedures described below were not changed in the revised manual and thus they are still in effect.

*Criteria:* According to the LSC Administrative Manual, the following procedures are required to be followed in the process of hiring consultants.

- The Contract Approval Form must be used. The Contract Approval is the form that must be executed by the originator of any contract and signed by the General Counsel or his designee, and Comptroller prior to LSC awarding a contract.
- The Office of Legal Affairs (OLA) must approve contracts for form and legal sufficiency before they are awarded. Such approval must be provided in writing by notation on the Contract Approval Cover Sheet.

**APPENDIX A**  
**Deficiencies in Internal Control Over Financial Reporting**

- The Comptroller must approve all contracts before they are awarded to ensure that the requirements of the Administrative Manual have been followed prior to the award of the contract and the preparation of a purchase order. Such approval must be provided in writing by notation on the Contract Approval Cover Sheet.

*Effect:* Non-compliance with established policies and procedures increases the risk of errors and inappropriate agreements and contracts not being detected by management.

*Cause:* As the Administrative Manual was being revised during the fiscal year 2009, certain policies and procedures in the old manual were not strictly followed by the management with the expectation that changes to procedures will be made.

*Recommendation:* We recommend that procedures be implemented to ensure that policies and procedures for contracts are followed.

*Management Response:* As indicated in Management's response to the OIG audit of LSC's contracting practices, LSC is now strictly adhering to the contracting policies in the Administrative Manual.

**3. Lack of Evidence of Review of Check Runs for Grant Disbursements**

*Condition:* During our review of check payments to grantees, we noted that check runs were not initialed by the Accounting Manager or the Comptroller. According to management, for check disbursements relating to grants, the procedure is to review the check run report before the final electronically signed check copies are printed. However, we noted no evidence of review by the Accounting Manger or the Comptroller on the check run reports relating to the checks we reviewed.

*Criteria:* According to LCS's Accounting Manual, the Accounting Manager and the Controller initial the check stubs as evidence of review and approval for check payments.

*Effect:* The lack of review of electronic check runs increases the risk of manual errors not being prevented or detected timely.

*Cause:* The reviewers did not sign off on the check run reports as evidence of review.

*Recommendation:* We recommend that the Comptroller or the Accounting Manager review and initial the check run reports as evidence of review before the actual checks are processed.

**APPENDIX A**  
**Deficiencies in Internal Control Over Financial Reporting**

*Management Response:* While the check run was not initialed, the month-to-month checks or TIG checks were requested by email. Because of the request, a batch was created by the Grants Accountant for the needed check(s). It was reviewed and posted by the Accounting Manager or the Comptroller and the checks produced. LSC's management believes that there are enough compensating controls in place for the production of these checks.

## **APPENDIX B**

### **Other Matters**



**APPENDIX B  
Other Matters**

**1. Long Outstanding Liabilities for Technology Initiative Grants**

*Condition:* Based on our discussion with management, 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. Based on our discussion with management, we were informed that the grantees can submit requests for extensions to meet the original deadlines for completion of milestones, and in most cases, extensions are granted. We also noted that new TIG grants continue to be awarded to the same grantees that have not yet completed their milestones under their previous grant awards. Extensions for milestones are usually requested by the grantees.

*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 no incentive for the grantees to complete the projects in a timely manner since new grants can be obtained regardless of the timeliness of milestones completed.

Our review indicated that there were 75 grantees that had outstanding balances prior to fiscal year 2009. The following table summarizes TIG payables which were outstanding prior to fiscal year 2009.

<u>September 30,</u>	<u>Amount Outstanding</u>
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
	<u>\$ 2,788,619</u>

*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.

## APPENDIX B Other Matters

*Recommendation:* We recommend that management implement procedures to perform periodic reviews of long outstanding TIG grant payables and take appropriate actions.

*Management Response:* For the 2009 grant cycle, management added a paragraph to the grant letter and to the emails announcing the posting of TIG awards that "the award of 2009 grants was conditional upon satisfactory progress in all previously awarded TIG grants." Grant awards may also be cancelled if the performance of the grantees is not satisfactory.

### 2. **No Formal Mechanism for Granting and Revoking Logical Access to Network and Applications**

*Observation:* We observed that there is no formal mechanism for granting and revoking logical access to LSC's network and applications. Approvals for granting individuals logical access to LSC's network and applications were not consistently administered.

*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.

## **APPENDIX B**

### **Other Matters**

*Recommendation:* We recommend that LSC allocates the resources necessary to ensure preventive, detective, and corrective procedures are implemented and monitored to ensure access controls are not compromised. It is important for policies and procedures to be documented, maintained, and updated, and that system access is appropriately granted, monitored and revoked consistent with agreed upon standards for required business needs. It is also important that individuals' access is documented and available for review by auditors and relevant stakeholders.

*Management Response:* LSC has adopted a new protocol for access to its computer network requiring written notice from supervisors prior to access being granted to new employees and mandating immediate revocation of access upon notification to OIT by OHR that an employee has been suspended or terminated.

### **3. Data Center Not Equipped with Effective Temperature Control Equipment**

*Observation:* We observed that the LSC's data center was not equipped with effective temperature control equipment, and as a result, the temperature in the data center was 80 degrees. Currently, LSC is using fans to supplement the central cooling system. This method is not very effective in light of the prevailing temperature inside the data center. Best practices suggest that the temperature range for a data center should be between 40-60 degrees.

*Criteria:* Protection of computer equipment and personnel requires well-designed and well-managed physical facilities. The process of managing the physical environment includes defining the physical site requirements, selecting appropriate facilities, and designing effective processes for monitoring environmental factors and managing physical access. Effective management of the physical environment reduces business interruptions from damage to computer equipment and personnel. The purpose of this is to manage the physical environment and protect computer assets and business data and minimizing the risk of business disruption by providing and maintaining a suitable physical environment to protect IT assets from access damage or theft and by implementing physical security measures and selecting and managing facilities.

Ensuring physical security measures are in line with the business requirements to secure the location and the physical assets. Physical security measures must be capable of effectively preventing, detecting and mitigating risks relating to theft, temperature, fire, smoke, water, vibration, terror, vandalism, power outages, chemicals or explosives (CobiT 4.1).

*Effect:* Computer equipment work at their optimum level when the temperature is maintained between 40-60 degrees. When the temperature goes above 75 degrees, the risk of system crashes increases which can result in significant data loss.

## **APPENDIX B**

### **Other Matters**

*Cause:* The room housing the Data Center was converted from office space and it was not retrofitted with the needed additional temperature control equipment at the time of conversion.

*Recommendation:* We recommend that LSC have their air conditioning unit fixed immediately and that they remove all unnecessary flammable products from the data center until such action has been taken. Once the air conditioning unit has been fixed, we recommend that they follow the best practice standard of maintaining the temperature in the data center at 40-60 degrees.

*Management Response:* Server room temperature control equipment will be replaced and upgraded in January 2010. The proposal for this project has already been approved and scheduled.

