MEMORANDUM

TO: Board of Directors
Legal Services Corporation

FROM: Kirt West Kirt West
Inspector General

SUBJECT: Transmittal of FY 2006 Financial Statement Audit Report

DATE: June 6, 2007

The Office of Inspector General (OIG) contracted with the independent certified public accounting firm of M.D. Oppenheim & Company, P.C. to audit the financial statements of the Legal Services Corporation (LSC) as of September 30, 2006 and 2005. 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 Unites States.

The Independent Auditor's Report by M.D. Oppenheim & Company, P.C. stated that LSC's financial statements present fairly, in all material respects, the financial position of LSC as of September 30, 2006 and September 30, 2005 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 Internal Control disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. This Report also noted no matters involving the internal control over financial reporting and its operation that were considered to be material weaknesses.

OIG reviewed the audit report from M.D. Oppenheim & Company, 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. M.D. Oppenheim and Company, P.C. is responsible for the attached auditor's report, dated March 1, 2007, along with the conclusions expressed in the report.

However, OIG's review disclosed no instances in which M.D. Oppenheim & Company, 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

LEGAL SERVICES CORPORATION

Financial Statements and
Independent Auditors' Report

September 30, 2006 and 2005

M.D. OPPENHEIM & COMPANY, P.C.
CERTIFIED PUBLIC ACCOUNTANTS

LEGAL SERVICES CORPORATION

September 30, 2006 and 2005

TABLE OF CONTENTS

PAGE

M.D. OPPENHEIM & COMPANY, P.C.
CERTIFIED PUBLIC ACCOUNTANTS
8403 Colesville Road, Suite 340 Silver Spring, Maryland 20910-3367
(301) 585-7990 FAX (301) 585-7975 www.mdocpa.com

Inspector General and Board of Directors
Legal Services Corporation
Washington, D.C.

INDEPENDENT AUDITORS' REPORT

We have audited the accompanying statements of net assets and governmental fund balance sheets of Legal Services Corporation ("LSC") as of September 30, 2006 and 2005 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, 2006 and 2005 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 for the year ended September 30, 2006, on pages 3–16 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 March 1, 2007 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.

M.D. Oppenheim & Company, P.C.

March 1, 2007

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis
For Year Ending September 30, 2006 and 2005

Overview of the Financial Statements

The annual financial report presents the LSC's financial performance and position in three parts:

Part 1, Management's Discussion and Analysis, provides a useful overview of LSC's financial positions with respect to assets and an overview of the FY 2006 operating budget experience.

Part 2, the Basic Financial Statements, includes two financial statements: the Statements of Net Assets and Governmental Fund Balance Sheet; and the Statements of Activities and Governmental Fund Revenue, Expenditures, and Change in Fund Balances. These statements are presented for the periods ending September 30, 2006, and 2005, for the readers to be able to compare year to year balances. The financial 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 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.

Part 3, Notes to the Financial Statements, provides further details on specific items contained in the tables in Part 2.

Financial Highlights

LSC receives its support from Federal appropriations and its derivative income, a grant from the U.S. Court of Veterans Appeals and from a new 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.

Operations in 2006 yielded an increase to the net assets of $475,046. When this amount, which is shown in the Statement of Activities and Governmental Fund Balance, Expenditures and Changes in Fund Balance, is added to the prior year's balance, the year-end net assets total $4,448,743. This compares to the increase in net assets in FY 2005 of $280,554, which resulted in year-end net assets of $3,973,697.

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis
For Year Ending September 30, 2006 and 2005

Financial Analysis of the Legal Services Corporation

The financial statements are a series of related reports that detail financial information using accounting methods similar to those used by other governmental non-profit entities. When reviewing the following condensed Statement of Net Assets table for FY 2006, the difference between total assets and total liabilities is $4,448,743, which compares to $3,973,697 in FY 2005. Results of operations for September 30, 2006, show a fund balance of $3,762,138, which compares to $3,277,824 in FY 2005. Net investment in capital assets in FY 2006 and FY 2005 total $686,605 and $695,873, respectively.

Table 1
Statement of Net Assets

	September 30	
	2006	2005
Total Current Assets and Other Assets	$ 61,750,170	$ 62,486,643
Net Property and Equipment	686,605	695,873
Total Assets	$ 62,436,775	$ 63,182,516
Grants and Contracts Payable	$ 56,656,312	$ 56,863,552
Other Liabilities	1,136,330	1,073,232
Deferred Revenue	195,390	1,272,035
Total Liabilities	57,988,032	59,208,819
Net Assets		
Fund Balances	3,762,138	3,277,824
Investment in capital assets	686,605	695,873
Total Net Assets	4,448,743	3,973,697
Total Liabilities and Net Assets	$ 62,436,775	$ 63,182,516

Management's Discussion and Analysis
For Year Ending September 30, 2006 and 2005

Table 2 presents a comparison of 2006 and 2005 revenues. In 2006, Congressional appropriations, a grant from the U.S. Court of Veterans Appeals, partnership funds from the State Justice Institute and other revenues totaled $329,537,693, and expenditures for program activities and support activities totaled $329,062,647. In 2005, revenues totaled $334,226,622 and expenditures for program activities and support activities were $333,946,068. Table 2 provides a review of each year's operating results.

Table 2
Change in Net Assets

	Years ended September 30, 2006	2005
Revenue		
Federal appropriations	$ 326,577,984	$ 330,803,705
Grant revenue	1,575,951	1,106,803
General revenues		
Change in deferred revenue	1,066,961	2,117,687
Interest & Other income	316,797	198,427
Total revenue	329,537,693	334,226,622
Expenses		
Program activities	313,913,625	318,780,977
Supporting activities	15,149,022	15,165,091
Total expenses	329,062,647	333,946,068
Change in net assets	475,046	280,554
Net Assets, beginning of year	3,973,697	3,693,143
Net Assets, end of year	$ 4,448,743	$ 3,973,697

Declines in Federal appropriations were based upon Federal budget considerations, not a decline in the needs for legal services. This year's grant revenues were from the U.S. Court of Veterans Appeals and new funds from a partnership with the State Justice Institute. The Board of Directors of LSC continues to seek increases in funding from Congress to provide adequate funding for legal services programs.

Capital Assets and Long-term Debt

Categories of capital assets are reported in Table 3. There is no short or long-term debt activity regarding capital assets.

Table 3
Capital Assets

	2006	2005
Furniture and Equipment	$ 451,474	$ 431,020
Software	84,085	106,091
Leasehold Improvements	151,046	158,762
Total Capital Assets (net)	$ 686,605	$ 695,873

General Fund Budgetary Analysis

The Legal Services Corporation Act of 1974 created LSC to promote equal access to justice and to provide high-quality civil legal aid to low-income Americans. Each year, as part of the Federal budget process, Congress appropriates money for LSC and stipulates how it is to be used.

LSC's largest budget line item—by far—is basic field grants, which are used to provide civil legal aid to low-income Americans. In FY 2006, LSC distributed grants to 138 programs in the 50 states, the District of Columbia, Puerto Rico, the Virgin Islands, Guam, Micronesia and American Samoa. Some programs also receive grants for technology initiatives. All grants are awarded through a competitive process.

LSC's Congressional appropriation also includes budget line items for management and administration, and the Office of Inspector General (OIG).

Budget Process

With respect to LSC administration, the budget process maximizes the use of funds available for field grants and technology initiatives. To assure the effective use of Management and Administration funds, office directors review their offices' monthly activities and expenditures. LSC's Treasurer/Comptroller, Chief Administrative Officer, and President evaluate this information and make necessary adjustments to ensure that plans and spending are in accordance with strategic directions.

The Inspector General provides OIG budget information to the Treasurer/Comptroller. This information is similar to the information provided for the LSC management and administration budget. The same review schedule for activities, expenditures, projections and budgetary adjustments is followed for the OIG and the LSC management and administration budget.

The Treasurer/Comptroller prepares a combined report and presents it to the LSC Board of Directors with the President's and the Inspector General's recommended adjustments. This combined presentation affords the Board an opportunity to review and compare each office's budget and actual expenditures to establish revised priorities or to reaffirm policy directions to advance strategic directions.

FY 2006 Highlights

In fiscal year 2006, the Legal Services Corporation:

- Released a groundbreaking report entitled Documenting the Justice Gap in America: The Current Unmet Civil Legal Needs of Low-Income Americans. The Justice Gap Report confirms that our nation falls far short of meeting the need for civil legal aid among low-income Americans. For two months, LSC-funded programs recorded the number of eligible people who came to their offices that they were unable to serve. On average, for every person served, one was turned away—only 50 percent of those who actually sought help received it. Other surveys indicate that 80 percent of the need is unmet. Even this may be an understatement—many people who are eligible for civil legal aid do not seek it. Moreover, the analysis for the Justice Gap Report was completed before last year's catastrophic storms.

- Published Strategic Directions 2006-2010, LSC's blueprint for the future. The five-year plan includes three strategic goals: (1) to increase public awareness of—and support for—programs providing civil legal aid to low-income Americans in order that more of their needs can be appropriately addressed; (2) to enhance the quality and compliance of legal services programs; and (3) to ensure that LSC operates efficiently and effectively.

- Assessed the performance of 32 programs—to ensure they are delivering high-quality service—in California, Delaware, Florida, Kentucky, Louisiana, Michigan, Minnesota, Mississippi, New Mexico, New York, Nevada, Ohio, Pennsylvania, South Carolina, Tennessee, Texas, Virginia, and Wisconsin. With a focus on quality, LSC's Office of Program Performance (OPP) examines many aspects of program operations. These include setting priorities, intake systems, managing and supervising legal work, governance, private attorney involvement, resource development, and strategic planning. After program visits, OPP provides feedback that includes findings and recommendations, and follows up periodically.

- Conducted on-site compliance reviews of 12 programs—to ensure they are complying with the Legal Services Act, LSC regulations, and Congressional restrictions—in Florida, Missouri, New Jersey, New York, North Carolina, Ohio, Oregon, Pennsylvania, and Tennessee. In addition to performing compliance reviews, LSC's Office of Compliance and Enforcement (OCE) requires prior approval for certain expenditures and activities, and conducts training. After reviewing a program, OCE provides a written report that details findings, required corrective actions, and recommendations. OCE also addresses complaints and investigates and responds to audit findings referred by the Office of Inspector General.

- Evaluated 48 proposals for 2007 grants for service areas in 22 states and American Samoa, including multiple proposals for selected service areas in South Carolina and Florida, and the entire state of Wyoming. Grant awards for 2007 are announced in December 2006.

- Issued revised Performance Criteria, the centerpiece of LSC's Quality Agenda, to serve as a basis for evaluating program performance and determining grant awards. The revised Performance Criteria's major themes include: LSC-funded programs work with limited resources, so they must make strategic choices about allocating resources and continually evaluate the consequences; LSC-funded programs have grown in size and complexity, necessitating an expanded focus on governance and management; and LSC-funded programs operate as part of integrated, statewide systems for delivering civil legal aid to low-income Americans.

- Awarded 31 new Technology Initiative Grants totaling nearly $1.6 million, including approximately $320,000 in matching funds provided by the State Justice Institute for 10 joint projects focused on *pro se* access. Nearly 50 percent of the funds are going to *pro se* initiatives and 40 percent to Web sites; the remaining 10 percent will be used for training, technical assistance, and intake systems.

- Launched a Pilot Loan Repayment Assistance Program to encourage recent graduates to enter legal services work and make it a career—and to help programs recruit and retain attorneys. This year, 70 attorneys in 24 LSC-funded programs received grants. Each attorney can receive up to $5,000 per year, which can be renewed for up to three years, for a total of $15,000, provided the attorney stays with the program. Participants range from new recruits to attorneys with up to three years of service when the program began.

- Launched a Leadership Pilot Mentoring Program to identify, nurture, and support a well-trained and diverse group of future leaders for the legal services community as a whole—and to create leadership mentoring models LSC-funded programs can replicate. Mentors and protégés participated in several training activities and projects. For example, working in pairs or in larger groups, they explored ways to encourage private attorney involvement with LSC-funded programs, using hypothetical, but true to life, scenarios.

- Completed the information-gathering stage of a major Board of Directors initiative to enhance pro bono partnerships between LSC-funded programs and the private bar, based on the input—and varying perspectives—of large law firms and corporate counsels, small law firms and solo practitioners, and law schools.

- Held a "conversation on quality" with legal services leaders in Alabama, Arkansas, Louisiana, and Mississippi. The group discussed problems and celebrated successes such as the establishment of Access to Justice Commissions in all four states. Afterwards, participants asked LSC to facilitate ongoing meetings to provide a forum for continued discussion of opportunities and problems endemic to the region: a highly disadvantaged poverty population, relatively few sources of funding, growing demand for services, and high turnover among staff.

- Began updating the Case Service Reporting System, last revised in 2001, and an accompanying handbook that defines data elements—for example, what programs may count as a "case." The goal is to ensure that LSC-funded programs provide consistent data that accurately reflects the nature and scope of their work.

- Convened a "disaster response conversation" in New Orleans on June 1, the first day of the hurricane season, for legal services leaders from seven states: Alabama, Arkansas, Florida, Louisiana, Mississippi, Tennessee, and Texas. Major themes included planning, coordinating, and partnering at all levels; improving relationships with the Federal Emergency Management Agency and the American Red Cross; and evacuation and post-disaster planning for low-income areas. At the participants' request, LSC hosts biweekly conference calls where the conversation continues. The group plans to create a permanent disaster assistance website modeled after www.katrinalegalaid.org. Thus, the lessons learned from Hurricane Katrina will enhance the legal services community's planning and response to future disasters.

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis
For Year Ending September 30, 2006 and 2005

Table 4 presents a comparison of the original and final reviewed operating budget for management and administration (M&A).

Table 4
Management & Administration
Original and Revised FY 2006 Operating Budget

Budget Category	Original Budget	Final Budget	Increase (Decrease)
Compensation and benefits	$ 9,943,125	$ 9,836,556	$ (106,569)
Temporary employee pay	281,150	338,669	57,519
Consulting	971,448	983,698	12,250
Travel and transportation expenses	717,950	732,700	14,750
Communications	170,100	152,950	(17,150)
Occupancy cost	1,677,075	1,668,460	(8,615)
Printing and reproduction	148,050	141,450	(6,600)
Other operating expenses	574,000	639,515	65,515
Capital expenditures	290,000	278,900	(11,100)
Total	$ 14,772,898	$ 14,772,898	$ 0

As a result of the quarterly expenditure reviews, internal budgetary adjustments were made to increase temporary employee pay consulting, travel and other operating expenditures. These funds were available through savings from personnel compensation and benefits, and other budget categories.

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis
For Year Ending September 30, 2006 and 2005

FY 2006 OIG Budgetary Analysis and Activity Description

The OIG has two principal missions, pursuant to the Inspector General Act: to assist management in identifying ways to promote efficiency and effectiveness in the activities and operations of LSC and its grantees, and to prevent and detect fraud, waste and abuse. Additionally, Congress gave the OIG responsibility for overseeing the monitoring of annual audits of grantees by independent accountants. Finally, the OIG conducts on-site reviews of grantees as appropriate. To accomplish its mission, the OIG has created its own multi-year strategic plan and an annual work plan.

The FY 2006 OIG budget funded reviewing both LSC grant recipient and internal LSC management operations and activities. Externally focused projects included the review of the grantees' audit reports and referrals of significant findings to LSC management for resolution, audit quality reviews of grantee independent public accountants' work, an investigation of a grant recipient's violations of Congressional restrictions and the LSC Act, and investigations related to theft or embezzlement of grantee funds. Funded projects with an internal focus included the Review of the Office of Compliance and Enforcement, Review of Compressed Work Schedule and Compensatory Time Practices, the FY 2005 LSC Corporate Audit, Review of Certain Fiscal Practices at LSC, comments on significant LSC regulatory and policy initiatives, LSC's Strategic Directions document, and the American Bar Association's Standing Committee on Legal Aid and Indigent Defendants Task Force on the Revision of the Standards for Providers of Civil Legal Services to the Poor. Additionally, the funded reviews of the Office of Program Performance and the Office of Information Management and the development of the OIG's Strategic Plan were still in process at the end of the fiscal year, but close to completion.

The OIG budget presentation in Table 5 presents a comparison of the original and final operating budget for FY 2006. During the year, only a few small reallocations of monies across the budget categories took place in order to increase funding for regular employees by reducing temporary employee pay and consulting budget lines.

Table 5
Office of Inspector General
Original and Revised FY 2006 Operating Budget

Budget Category	Original Budget	Final Budget	Increase (Decrease)
Compensation and benefits	$ 2,245,825	$ 2,321,825	$ 76,000
Temporary employee pay	150,950	140,950	(10,000)
Consulting	249,921	182,921	(67,000)
Travel and transportation expenses	119,000	119,000	0
Communications	14,000	14,000	0
Occupancy cost	1,000	1,000	0
Printing and reproduction	2,700	4,200	1,500
Other operating expenses	20,000	26,500	6,500
Capital expenditures	30,000	23,000	(7,000)
Total	$ 2,833,396	$ 2,833,396	$ 0

Management's Discussion and Analysis
For Year Ending September 30, 2006 and 2005

Table 6 presents the final M&A budget and expenditures for FY 2006, as well as the budget category variances. We continue to have a number of open positions; over half of the total variance is attributable to personnel compensation and benefits.

Table 6
Management & Administration
Operating Budget versus Actual Expenditures

Budget Category	Final Budget	Expenditures	Variance
Compensation and benefits	$ 9,836,556	$ 8,567,870	$ (1,268,686)
Temporary employee pay	338,669	217,358	(121,311)
Consulting	983,698	622,415	(361,283)
Travel and transportation expenses	732,700	584,180	(148,520)
Communications	152,950	125,068	(27,882)
Occupancy cost	1,668,460	1,660,545	(7,915)
Printing and reproduction	141,450	75,719	(65,731)
Other operating expenses	639,515	570,606	(68,909)
Capital expenditures	278,900	264,406	(14,494)
Total	$ 14,772,898	12,688,167	(2,084,731)
Depreciation and amortization		280,317	280,317
Loss on disposal of assets		561	561
Less: Capitalized assets		(264,857)	(264,857)
		$ 12,704,188	$ (2,068,710)

Management's Discussion and Analysis
For Year Ending September 30, 2006 and 2005

Table 7 presents the OIG FY 2006 final budget, expenditures and budget category variances. The expenditure variances from budget resulted from two staff departures in the forth quarter and a separate unfilled staff position. Additional variances in the consulting and travel categories were a result of Congressionally-requested work requiring the OIG to focus on internal LSC practices.

Table 7
Office of Inspector General
Operating Budget versus Actual Expenditures

Budget Category	Final Budget	Expenditures	Variance
Compensation and benefits	$ 2,321,825	$ 2,177,625	$ (144,200)
Temporary employee pay	140,950	125,978	(14,972)
Consulting	182,921	51,189	(131,732)
Travel and transportation expenses	119,000	51,817	(67,183)
Communications	14,000	11,509	(2,491)
Occupancy cost	1,000	700	(300)
Printing and reproduction	4,200	2,519	(1,681)
Other operating expenses	26,500	20,824	(5,676)
Capital expenditures	23,000	6,755	(16,245)
Total	$ 2,833,396	2,448,916	(384,480)
Depreciation and amoritzation		0	0
Loss on disposal of assets		0	0
Less: Capitalized assets		(6,754)	(6,754)
		$ 2,442,162	$ (391,234)

Management's Discussion and Analysis
For Year Ending September 30, 2006 and 2005

Table 8 provides the same budget, expenditure, and variance information for Basic Field Programs, U.S. Court of Veterans Appeals Funds, Grants from Other Funds and Technology Initiatives. 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. The unexpended Basic Field Programs funds are earmarked for funding one of our grantees that is on month-to-month funding. The unexpended U.S. Court of Veterans Appeals funds are to be used to support next year's grant. The unexpended Technology Initiative funds are to be used for future technology grants. Because the projects are restricted by legislation, they are considered unearned until the projects are completed.

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. Because no special grants or emergency grants were requested this year, the full amount of funds available in FY 2006 remains available for future grants.

Table 8
Program Budget Versus Actual Expenditures

	Budget	Expenditures	Variance
Basic Field Programs	$ 310,196,242	$ 310,043,596	$ 152,646
U.S. Court of Veterans Appeals	1,285,089	1,257,084	28,005
Technology Inititatives	2,767,183	2,752,445	14,738
Grants From Other Funds	228,799	0	228,799
Total	$ 314,477,313	$ 314,053,125	$ 424,188

For budgeting purposes and full reporting to LSC's Board of Directors and the public, there is a slight reporting difference between the Management Discussion and Analysis tables, which are derived for the monthly interim financial reports, and the annual financial statement. The Program budget versus expenditures shown above reports grant expenditures of $314,053,125 and the Statement of Activities reports grant expenditures of $313,913,625; the difference is $139,500. This is the amount of FY 2006 grant recoveries and this total is shown during the year as revenue collected outside of the appropriation 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 E – Grant and Contracts Expense.

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis
For Year Ending September 30, 2006 and 2005

Future Events

LSC recognizes the importance of and will continue to monitor its grantees for compliance with Federal laws and LSC regulations. LSC will continue to work on important initiatives to support its grantees and to improve the quality and accessibility of legal services for the indigent, including the use of technology to promote and facilitate access to civil legal services. The detailed goals, objectives and strategies which LSC will pursue are enumerated in the updated Strategic Directions 2006-2010.

The OIG provides the LSC and Congress with 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 accord with the IG Act and the LSC appropriation. The OIG will continue to carry out its Congressionally-assigned responsibility to oversee the independent public accountant's reviews, conduct its own reviews of grantees compliance and evaluate the effectiveness and efficiency of LSC and its grant recipients operations.

LSC has focused its resources for FY 2007 to continue to advance these efforts. For FY 2007, the U.S Congress passed the *Revised Continuing Appropriation Resolution, 2007* (Public Law 110-5) which provides LSC funding of approximately $349 million.

Basic Financial Statements

LEGAL SERVICES CORPORATION
STATEMENT OF NET ASSETS AND GOVERNMENTAL FUND BALANCE SHEET
September 30, 2006

	General Fund	Adjustments (Note A)	Statement of Net Assets
ASSETS			
Cash and cash equivalents	$ 61,324,772	$	$ 61,324,772
Loans receivable	167,013		167,013
Accounts receivable	4,881		4,881
Prepaid expenses and deposits	253,504		253,504
Capital assets (net)		686,605	686,605
Total Assets	$ 61,750,170	$ 686,605	$ 62,436,775
LIABILITIES			
Grants and contracts payable	$ 56,656,312	$	$ 56,656,312
Accounts payable	435,498		435,498
Accrued vacation and other liabilities	700,832		700,832
Deferred revenue	195,390		195,390
Total Liabilities	57,988,032		57,988,032
FUND BALANCES / NET ASSETS			
Fund balances:			
Reserved	1,278,920		
Unreserved	2,483,218		
Total fund balances	3,762,138		
Total liabilities and fund balances	$ 61,750,170		
Net assets:			
Invested in capital assets, net of related debt		686,605	686,605
Restricted		3,762,138	3,762,138
Total Net Assets		$ 4,448,743	4,448,743
TOTAL LIABILITIES AND NET ASSETS			$ 62,436,775

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	$ 3,762,138
Capital assets used in governmental activities are not financial resources, and, therefore, are not reported in the fund financial statements	686,605
Total net assets	$ 4,448,743

See accompanying notes and Independent Auditors' Report.

LEGAL SERVICES CORPORATION
STATEMENT OF NET ASSETS AND GOVERNMENTAL FUND BALANCE SHEET
September 30, 2005

	General Fund	Adjustments (Note A)	Statement of Net Assets
ASSETS			
Cash and cash equivalents	$ 62,266,548	$	$ 62,266,548
Accounts receivable	2,825		2,825
Prepaid expenses and deposits	217,270		217,270
Capital assets (net)		695,873	695,873
Total Assets	$ 62,486,643	$ 695,873	$ 63,182,516
LIABILITIES			
Grants and contracts payable	$ 56,863,552	$	$ 56,863,552
Accounts payable	370,554		370,554
Accrued vacation and other liabilities	702,678		702,678
Deferred revenue	1,272,035		1,272,035
Total Liabilities	59,208,819		59,208,819
FUND BALANCES / NET ASSETS			
Fund balances:			
Reserved	1,129,367		
Unreserved	2,148,457		
Total fund balances	3,277,824		
Total liabilities and fund balances	$ 62,486,643		
Net assets:			
Invested in capital assets, net of related debt		695,873	695,873
Restricted		3,277,824	3,277,824
Total Net Assets		$ 3,973,697	3,973,697
TOTAL LIABILITIES AND NET ASSETS			$ 63,182,516

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	$ 3,277,824
Capital assets used in governmental activities are not financial resources, and, therefore, are not reported in the fund financial statements	695,873
Total net assets	$ 3,973,697

See accompanying notes and Independent Auditors' Report.

LEGAL SERVICES CORPORATION
STATEMENT OF ACTIVITIES AND GOVERNMENTAL FUND REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
Year ended September 30, 2006

	General Fund	Adjustments (Note A)	Statement of Activities
EXPENDITURES/EXPENSES			
Grants	$ 313,913,625	$	$ 313,913,625
Board of Directors	238,611		238,611
Executive Office	904,406		904,406
Legal Affairs	896,665		896,665
Governmental Relations and Public Affairs	708,625	(7,986)	700,639
Human Resources	482,077		482,077
Financial and Administrative Services	2,884,804	(129,812)	2,754,992
Information Technology	1,000,094	(126,497)	873,597
Program Performance	2,690,281		2,690,281
Information Management	776,537		776,537
Compliance and Enforcement	2,108,739		2,108,739
Office of Inspector General	2,448,915	(6,754)	2,442,161
Depreciation/amortization		280,317	280,317
Total expenditures/expenses	329,053,379	9,268	329,062,647
PROGRAM REVENUES			
Federal Appropriations	326,577,984		326,577,984
U.S. Court of Veterans Appeals Funds	1,575,951		1,575,951
Change in deferred revenue	1,066,961		1,066,961
Total program revenues	329,220,896	-	329,220,896
GENERAL REVENUES			
Interest and other income	316,797		316,797
Total general revenues	316,797	-	316,797
Excess of revenues over expenses	484,314	(484,314)	-
Change in net assets		475,046	475,046
Fund Balance/net assets:			
Beginning of the year	3,277,824		3,277,824
Invested in capital assets, net		695,873	695,873
Net Assets, End of the year	$ 3,762,138	$ 686,605	$ 4,448,743

See accompanying notes and Independent Auditors' Report.

LEGAL SERVICES CORPORATION
STATEMENT OF ACTIVITIES AND GOVERNMENTAL FUND REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
Year ended September 30, 2006

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			$	484,314
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 capital outlays exceeded depreciation expense during the current period.				(9,268)
Change in net assets			$	475,046
	Fund balance:			
	Beginning of year	$ 3,277,824		
	Net change	484,314		
	End of year	3,762,138	$	3,762,138
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	(484,314)		
	Change in net assets	475,046		
	Capital assets, beginning	695,873		
	Capital assets (net)	$ 686,605		686,605
Total net assets			$	4,448,743

See accompanying notes and Independent Auditors' Report.

LEGAL SERVICES CORPORATION
STATEMENT OF ACTIVITIES AND GOVERNMENTAL FUND REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
Year ended September 30, 2005

	General Fund	Adjustments (Note A)	Statement of Activities
EXPENDITURES/EXPENSES			
Grants	$ 318,780,977	$	$ 318,780,977
Board of Directors	260,380		260,380
Executive Office	641,936		641,936
Legal Affairs	1,068,673		1,068,673
Governmental Relations and Public Affairs	581,079		581,079
Human Resources	470,971		470,971
Financial and Administrative Services	2,876,832	(18,369)	2,858,463
Information Technology	985,818	(162,423)	823,395
Program Performance	2,725,109		2,725,109
Information Management	820,128		820,128
Compliance and Enforcement	2,213,278		2,213,278
Office of Inspector General	2,412,825	(46,594)	2,366,231
30th Anniversary	59,145		59,145
Depreciation/amortization		276,303	276,303
Total expenditures/expenses	333,897,151	48,917	333,946,068
PROGRAM REVENUES			
Federal Appropriations	330,803,705		330,803,705
U.S. Court of Veterans Appeals Funds	1,106,803		1,106,803
Change in deferred revenue	2,117,687		2,117,687
Total program revenues	334,028,195	-	334,028,195
GENERAL REVENUES			
Interest and other income	198,427		198,427
Total general revenues	198,427	-	198,427
Excess of revenues over expenses	329,471	(329,471)	-
Change in net assets		280,554	280,554
Fund Balance/net assets:			
Beginning of the year	2,948,353		2,948,353
Invested in capital assets, net		744,790	744,790
Net Assets, End of the year	$ 3,277,824	$ 695,873	$ 3,973,697

See accompanying notes and Independent Auditors' Report.

LEGAL SERVICES CORPORATION
STATEMENT OF ACTIVITIES AND GOVERNMENTAL FUND REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
Year ended September 30, 2005

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			$	329,471
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 capital outlays exceeded depreciation expense during the current period.				(48,917)
Change in net assets			$	280,554
	Fund balance:			
	Beginning of year	$ 2,948,353		
	Net change	329,471		
	End of year	3,277,824	$	3,277,824
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	(329,471)		
	Change in net assets	280,554		
	Capital assets, beginning	744,790		
	Capital assets (net)	$ 695,873		695,873
Total net assets			$	3,973,697

See accompanying notes and Independent Auditors' Report.

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2006 and 2005

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

1. *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.

Prior to FY 2005, Friends of the Legal Services Corporation ("FoLSC"), a District of Columbia nonprofit corporation, was reported in the disclosure notes of LSC's financial statements as a discretely presented component unit as defined by the Governmental Accounting Standards Board (GASB). This disclosure was necessary because the significance of FoLSC's operating and financial relationship with LSC was such that exclusion would cause LSC's financial statements to be misleading or incomplete. In FY 2005, due to a change in FoLSC management, FoLSC no longer met the criteria for being reported as a discrete component unit of LSC.

2. *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 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 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.

3. *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.

4. *Cash and Cash Equivalents*: LSC's cash and cash equivalents includes a fund balance with U.S. Treasury of $33,120,904 and $33,345,058 at September 30, 2006 and 2005, respectively.

5. *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.

6. *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.

7. *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.

8. *Fund Balance / Net Assets:* The Board of Directors, through its fund allocation process, has designated $1,278,920 and $1,129,367 of the fund balance for continuing programs and administrative activities as of September 30, 2006 and 2005, respectively. Net assets are reported as restricted due to constraints imposed for their use by Congressional appropriation legislation.

9. *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.

10. *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.

11. *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.

12. *Concentration of Revenue*: LSC receives substantially all of its revenue from direct Federal government appropriations.

NOTE B – 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, 2006, $11,987,538 of LSC's bank balance of $28,358,538 was exposed to custodial credit risk as follows:

Uninsured and uncollateralized	$	-0-
Uninsured and collateral held by pledging bank's trust department not in LSC's name		11,987,538
Total	$	11,987,538

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2006 and 2005

NOTE C - EQUIPMENT:

Property and equipment consists of the following at September 30, 2006

	Beginning Balance	Additions	Disposals	Ending Balance
Furniture and equipment	$ 1,692,685	$ 234,855	$ (40,791)	$ 1,886,749
Software	360,030	15,571	-	375,601
Leasehold improvements	223,932	21,184	-	245,116
Subtotal	2,276,647	271,610	(40,791)	2,507,466
Less: Accumulated	1,580,774	280,317	(40,230)	1,820,861
Capital assets (net)	$ 695,873	$ (8,707)	$ (561)	$ 686,605

Property and equipment consists of the following at September 30, 2005

	Beginning Balance	Additions	Disposals	Ending Balance
Furniture and equipment	$ 1,654,044	$ 126,203	$ (87,562)	$ 1,692,685
Software	318,739	91,753	(50,462)	360,030
Leasehold improvements	209,587	14,345		223,932
Subtotal	2,182,370	232,301	(138,024)	2,276,647
Less: Accumulated	1,437,580	276,302	(133,108)	1,580,774
Capital assets (net)	$ 744,790	$ (44,001)	$ (4,916)	$ 695,873

Depreciation expense for the years ended September 30, 2006 and 2005 are $280,317 and $276,3032, respectively.

NOTE D - GRANT REVENUE:

LSC was awarded grants from the U.S. Court of Veterans Appeals for the purpose of furnishing legal assistance to veterans in the amount of $1,247,400 for 2006 and $1,100,000 for 2005. Grant revenues for the years ended September 30, 2006 and 2005, total $1,257,084 and $1,106,803, respectively.

NOTE E - GRANT AND CONTRACTS EXPENSE:

Grant funding provided to the Legal Services Corporation, pursuant to Public Law 108-447, was for basic field programs. Grant and contracts expense for the years ended September 30, 2006 and 2005, consists of the following:

	2006	2005
Basic field programs	$ 310,043,596	$ 315,343,286
U.S. Court of Veterans Appeals fund	1,257,084	1,106,803
Technology Initiatives	2,752,445	2,213,111
Grants from other funds	0	259,450
Grant recoveries	(139,500)	(141,673)
Totals	$ 313,913,625	$ 318,780,977

NOTE F - RETIREMENT PLANS:

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

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

Post-retirement benefits are paid for by the OPM. No amounts have been recognized in the financial statements for these imputed costs as they are not deemed material.

LSC does not report in its financial statements CSRS or FEHB assets, accumulated plan benefits or unfunded liabilities, if any, applicable to its employees.

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

LSC's contributions to these plans for the years ended September 30, 2006 and 2005 were $719,605 and $674,893, respectively. These amounts are included in supporting activities for management and administration expenses. LSC also offers a tax deferred annuity savings plan for eligible employees. No contributions are made to this plan by LSC.

NOTE G – LEASES:

Related Party Lease

On June 1, 2003, LSC commenced an operating lease agreement for office space with the 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:

		Amount
September 30, 2007	$	1,710,000
2008		1,710,000
2009		1,710,000
2010		1,710,000
2011		1,710,000
Thereafter		2,850,000
Total	$	11,400,000

Rental expense for the years ended September 30, 2006 and 2005 is $1,710,000 each year. No amounts are due to or from FoLSC at September 30, 2006 and 2005.

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:

		Amount
September 30, 2007	$	63,772
2008		65,044
2009		66,323
2010		55,471
Total	$	250,610

Total sublease income in fiscal year 2006 and 2005 is approximately $53,609 and $6,756, respectively, and is reported as a reduction of rental expense in the accompanying financial statements.

NOTE H - CONTINGENCIES:

1. 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.

2. Claims: In January 2005, the former Executive Director of an LSC grantee filed a lawsuit against LSC and certain officers and employees of LSC seeking unspecified actual and punitive damages relating to allegations of defamation and slander, and related charges. A partial settlement agreement was reached in February 2006 and summary judgment on all remaining claims was awarded to LSC on May 12, 2006. An appeal has been filed by the former Executive Director with the United States Court of Appeals for the Fourth Circuit; the issue has been briefed and LSC is awaiting a decision from the Court. No amounts have been recorded in the financial statements for any contingent liability.

3. *Loan Repayment Assistance Program*: LSC initiated a Loan Repayment Assistance Program in 2006 that provided loans up to $5,000 annually for participating attorneys. As of September 30, 2006, loans totaling $167,013 have been given to 49 participating attorneys, and have been reflected as a receivable on the accompanying statement of net assets and governmental fund balance sheet. Each loan is to be forgiven provided 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.

M.D. OPPENHEIM & COMPANY, P.C.
CERTIFIED PUBLIC ACCOUNTANTS
8403 Colesville Road, Suite 340 Silver Spring, Maryland 20910-3367
(301) 585-7990 FAX (301) 585-7975 www.mdocpa.com

Inspector General and Board of Directors
Legal Services Corporation
Washington, D.C.

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*

We have audited the financial statements of Legal Services Corporation as of and for the year ended September 30, 2006 and have issued our report thereon dated March 1, 2007. 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 in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain other matters that we reported to management of LSC in a separate letter dated March 1, 2007.

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. However this report is a matter of public record and its distribution is not limited.

M.D. Oppenheim & Company, P.C.

March 1, 2007

M.D. OPPENHEIM & COMPANY, P.C.
CERTIFIED PUBLIC ACCOUNTANTS
8403 Colesville Road, Suite 340 Silver Spring, Maryland 20910-3367
(301) 585-7990 FAX (301) 585-7975 www.mdocpa.com

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, 2006, 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 March 1, 2007). This letter does not affect our report dated March 1, 2007, 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 user access to the SunSystems accounting system, accounting and reporting of fixed assets, and documentation of certain control procedures.

1. User Access to SunSystems Accounting System

Financial and program staff have different types of user access in LSC's SunSystems accounting system based on their job responsibilities. LSC does not have written policies and procedures to periodically recertify user access in this system. Lack of recertification increases the risk that employees whose job functions have changed, or are no longer with the Corporation, could have access to SunSystems that is no longer appropriate. We recommend that LSC annually recertify every user in SunSystems to ensure their access is appropriate for their current job responsibilities.

2. Accounting and Reporting of Fixed Assets

In our FY 2005 audit, we made recommendations on certain areas where LSC could strengthen the internal controls or improve the efficiency over its accounting and reporting for fixed assets. Management reviewed our recommendations and made changes it deemed to be appropriate. Our audit testing in FY 2006 did not find evidence of the same errors that were reported in FY 2005.

However, in FY 2006, we noted other areas where controls could be strengthened or improved:

2. **Accounting and Reporting of Fixed Assets (continued)**

- Fixed assets no longer in use by the Corporation (but not yet physically disposed) are not being segregated in the fixed asset records and are still being reported as assets in use in the notes to the financial statements. LSC does not have written policies and procedures to evaluate the condition and use of its assets on a regular basis and to properly reflect in its fixed asset records those assets that are no longer in usable condition and awaiting disposal.

  We recommend that LSC develop policies and procedures to annually evaluate the condition and use of its assets and to determine whether or not they continue to be in usable condition. Because a significant number of LSC's assets are information technology hardware and software, the Office of Information Technology should also be involved in performing these evaluations. Assets which are deemed to be obsolete or unusable but have not been disposed should be separately classified in its fixed asset records and an impairment (write-down) recorded, if necessary, to prevent being improperly being reported as assets in use.

- Calculation of depreciation expense and accumulated depreciation is done manually in spreadsheets which is cumbersome and prone to error. In FY 2006, an adjustment of approximately $47,000 was required to adjust depreciation expense and accumulated depreciation for assets that had not been properly calculated. In discussions with Management, LSC indicated it had previously considered utilizing the SunSystems fixed asset module but encountered some difficulties in its implementation.

  We recommend that LSC reconsider using the SunSystems fixed asset module to track and record its fixed assets and to automate the calculation of depreciation expense, accumulated depreciation, and net book value.

3. **Documentation of Certain Control Procedures**

LSC has a system of internal controls designed to ensure that financial reporting is accurate and that assets are safeguarded against misuse. Documentation of control procedures is important to provide evidence that the control has been performed and is operating effectively. We noted two areas where LSC could improve the documentation of its control procedures: 1) review of journal entries, and 2) review of invoices for accuracy.

3. **Documentation of Certain Control Procedures (continued)**

LSC records various accounting transactions through the use of journal entries in the SunSystems accounting system. We noted that although LSC's policy is to have the Comptroller or Accounting Manager review journal entries, there was inconsistent documentation that this review was performed. In addition, LSC has a well-designed process for reviewing, approving, and paying vendor invoices. One of the controls is that a member of the accounting staff reviews each invoice for accuracy before it is paid. However, based on our testing, we noted this review was also inconsistently documented.

We recommend that LSC update its policies and procedures to require the Accounting Manager or Comptroller to initial and date all journal entries to document their review and approval and that Management ensure that all invoices are reviewed for accuracy before they are paid.

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. However, this report is a matter of public record and its distribution is not limited.

M.D. Oppenheim & Company, P.C.

March 1, 2007

M.D. OPPENHEIM & COMPANY, P.C.
CERTIFIED PUBLIC ACCOUNTANTS
8403 Colesville Road, Suite 340 Silver Spring, Maryland 20910-3367
(301) 585-7990 FAX (301) 585-7975 www.mdocpa.com

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, 2006, 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 March 1, 2007). This letter does not affect our report dated March 1, 2007, 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 user access to the SunSystems accounting system, accounting and reporting of fixed assets, and documentation of certain control procedures.

1. **User Access to SunSystems Accounting System**

   Financial and program staff have different types of user access in LSC's SunSystems accounting system based on their job responsibilities. LSC does not have written policies and procedures to periodically recertify user access in this system. Lack of recertification increases the risk that employees whose job functions have changed, or are no longer with the Corporation, could have access to SunSystems that is no longer appropriate. We recommend that LSC annually recertify every user in SunSystems to ensure their access is appropriate for their current job responsibilities.

2. **Accounting and Reporting of Fixed Assets**

   In our FY 2005 audit, we made recommendations on certain areas where LSC could strengthen the internal controls or improve the efficiency over its accounting and reporting for fixed assets. Management reviewed our recommendations and made changes it deemed to be appropriate. Our audit testing in FY 2006 did not find evidence of the same errors that were reported in FY 2005.

   However, in FY 2006, we noted other areas where controls could be strengthened or improved:

2. **Accounting and Reporting of Fixed Assets (continued)**

- Fixed assets no longer in use by the Corporation (but not yet physically disposed) are not being segregated in the fixed asset records and are still being reported as assets in use in the notes to the financial statements. LSC does not have written policies and procedures to evaluate the condition and use of its assets on a regular basis and to properly reflect in its fixed asset records those assets that are no longer in usable condition and awaiting disposal.

  We recommend that LSC develop policies and procedures to annually evaluate the condition and use of its assets and to determine whether or not they continue to be in usable condition. Because a significant number of LSC's assets are information technology hardware and software, the Office of Information Technology should also be involved in performing these evaluations. Assets which are deemed to be obsolete or unusable but have not been disposed should be separately classified in its fixed asset records and an impairment (write-down) recorded, if necessary, to prevent being improperly being reported as assets in use.

- Calculation of depreciation expense and accumulated depreciation is done manually in spreadsheets which is cumbersome and prone to error. In FY 2006, an adjustment of approximately $47,000 was required to adjust depreciation expense and accumulated depreciation for assets that had not been properly calculated. In discussions with Management, LSC indicated it had previously considered utilizing the SunSystems fixed asset module but encountered some difficulties in its implementation.

  We recommend that LSC reconsider using the SunSystems fixed asset module to track and record its fixed assets and to automate the calculation of depreciation expense, accumulated depreciation, and net book value.

3. **Documentation of Certain Control Procedures**

LSC has a system of internal controls designed to ensure that financial reporting is accurate and that assets are safeguarded against misuse. Documentation of control procedures is important to provide evidence that the control has been performed and is operating effectively. We noted two areas where LSC could improve the documentation of its control procedures: 1) review of journal entries, and 2) review of invoices for accuracy.

3. **Documentation of Certain Control Procedures (continued)**

LSC records various accounting transactions through the use of journal entries in the SunSystems accounting system. We noted that although LSC's policy is to have the Comptroller or Accounting Manager review journal entries, there was inconsistent documentation that this review was performed. In addition, LSC has a well-designed process for reviewing, approving, and paying vendor invoices. One of the controls is that a member of the accounting staff reviews each invoice for accuracy before it is paid. However, based on our testing, we noted this review was also inconsistently documented.

We recommend that LSC update its policies and procedures to require the Accounting Manager or Comptroller to initial and date all journal entries to document their review and approval and that Management ensure that all invoices are reviewed for accuracy before they are paid.

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. However, this report is a matter of public record and its distribution is not limited.

M.D. Oppenheim & Company, P.C.

March 1, 2007