LSC

Legal Services Corporation
Office of Inspector General

MEMORANDUM

TO: Board of Directors
Legal Services Corporation

FROM: Ronald D. Merryman
Acting Inspector General

SUBJECT: Transmittal of FY 2007 Financial Statement Audit Report

DATE: January 7, 2008

The Office of Inspector General (OIG) contracted with the independent certified public accounting firm of WithumSmith+Brown, P.C. (formerly M.D. Oppenheim & Company, P.C.) to audit the financial statements of the Legal Services Corporation (LSC) as of September 30, 2007. The audit was conducted in accordance with auditing standards generally accepted in the United States of America, as well as the standards applicable to financial audits contained in the *Government Auditing Standards* issued by the Comptroller General of the United States.

The Independent Auditor's Report by WithumSmith+Brown, P.C. stated that LSC's financial statements present fairly, in all material respects, the financial position of LSC as of September 30, 2007 and the results of its operations and changes in its fund balance for the year then ended in conformity with accounting principles generally accepted in the United States.

The Independent Auditor's Report on Compliance and Internal Control identified a significant deficiency in internal control over financial reporting that the auditors considered to be a material weakness. The deficiency related to the lack of an internal control procedure for recording the settlement agreement with a former grantee as a receivable. LSC has implemented a new procedure to correct the deficiency.

OIG reviewed the audit report from WithumSmith+Brown, P.C. and related audit documentation and inquired of their representatives. Our review, as differentiated from an audit in accordance with generally accepted government auditing standards, was not intended to enable us to express, and we do not

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express, opinions on LSC's financial statements, or conclusions about compliance with applicable laws and regulations, or the effectiveness of internal controls. WithumSmith+Brown, P.C. is responsible for the attached auditor's report, dated December 21, 2007, along with the conclusions expressed in the report.

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

Attachment

cc: Helaine Barnett
President

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

Charles Jeffress
Chief Administrative Officer

WithumSmith+Brown
A Professional Corporation
Certified Public Accountants and Consultants

Legal Services Corporation

Financial Statements

September 30, 2007 and 2006

With Independent Auditors' Report

Legal Services Corporation
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September 30, 2007 and 2006

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Independent Auditors' Report

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

We have audited the accompanying statement of net assets and governmental fund balance sheet of Legal Services Corporation ("LSC") as of September 30, 2007 and the related statement of activities and governmental fund revenues, expenditures, and changes in fund balance 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. The financial statements as of September 30, 2006 were audited by M.D. Oppenheim & Company, P.C., who merged with us as of November 1, 2007, and whose report dated March 1, 2007 expressed an unqualified opinion on those statements.

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. 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 2007 financial statements referred to above present fairly, in all material respects, the financial position of LSC as of September 30, 2007 and the results of its operations and changes in its fund balance for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis which includes budget comparison information for the year ended September 30, 2007, on pages 3–14 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 December 21, 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.

Withum Smith + Brown, PC

December 21, 2007

Overview of the Financial Statements

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

Management's Discussion and Analysis provides a useful overview of LSC's financial positions with respect to assets for FY 2007 and FY 2006, and an overview of the FY 2007 operating budget experience.

The Basic Financial Statements include two financial statements: the Statements of Net Assets and Governmental Fund Balance Sheets; and the Statements of Activities and Governmental Fund Revenue, Expenditures, and Change in Fund Balances. These statements are presented for the periods ending September 30, 2007, and 2006, 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 Funds Balance Sheets summarize the net assets that are available to pay outstanding liabilities. The resulting balance is the amount of funds available to support next year's operations. The Statement of Activities and Governmental Fund Revenues, Expenditures, and Changes in Fund Balances provides the results of the identified year's operations.

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

Financial Highlights

LSC receives its support from 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 2007 yielded an increase to the net assets of $537,819. When this amount, which is shown in the Statement of Activities and Governmental Fund Revenue, Expenditures and Changes in Fund Balance, is added to the prior year's balance, the year-end net assets total $4,986,562. This compares to the increase in net assets in FY 2006 of $475,046, which resulted in year-end net assets of $4,448,743.

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 2007, the difference between total assets and total liabilities is $4,986,562, which compares to $4,448,743 in FY 2006. Results of operations for September 30, 2007, show a fund balance of $4,408,724; this compares to $3,762,138 in FY 2006. Net investment in capital assets in FY 2007 and FY 2006 total $577,838 and $686,605, respectively.

Table 1
Statement of Net Assets

	September 30	
	2007	2006
Total Current Assets and Other Assets	$ 68,249,559	$ 61,750,170
Net Property and Equipment	577,838	686,605
Total Assets	$ 68,827,397	$ 62,436,775
Grants and Contracts Payable	$ 59,611,053	$ 56,656,312
Other Liabilities	1,565,886	1,136,330
Deferred Revenue	2,663,896	195,390
Total Liabilities	63,840,835	57,988,032
Net Assets		
Fund Balances	4,408,724	3,762,138
Investment in capital assets	577,838	686,605
Total Net Assets	4,986,562	4,448,743
Total Liabilities and Net Assets	$ 68,827,397	$ 62,436,775

Table 2 presents a comparison of 2007 and 2006 revenues. In 2007, the Federal appropriation, a grant from the U.S. Court of Veterans Appeals, partnership funds from the State Justice Institute and other revenues totaled $348,192,917, and expenditures for program activities and support activities totaled $347,655,098. In 2006, revenues totaled $329,537,693, and expenditures for program activities and support activities were $329,062,647. Table 2 provides a review of each year's operating results.

Table 2
Change in Net Assets

	Years ended September 30, 2007	Years ended September 30, 2006
Revenue		
Federal appropriations	$ 348,578,000	$ 326,577,984
Grant revenue	1,596,379	1,575,951
General revenues		
Change in deferred revenue	(2,468,506)	1,066,961
Interest & Other income	487,044	316,797
Total revenue	348,192,917	329,537,693
Expenses		
Program activities	331,373,708	313,913,625
Supporting activities	16,281,390	15,149,022
Total expenses	347,655,098	329,062,647
Change in net assets	537,819	475,046
Net Assets, beginning of year	4,448,743	3,973,697
Net Assets, end of year	$ 4,986,562	$ 4,448,743

The Federal appropriation increased by $22,000,016 in FY 2007. This is LSC's first budget increase in four years and largest appropriation since 1995, when it received $400 million. More than 95 percent of the money Congress appropriates for LSC goes to local programs that provide civil legal aid for people living in poverty. Management and Administration is 4 percent of LSC's budget—low by any standard.

The FY 2007 Federal appropriation increase is attributed to the need that was reported in LSC's groundbreaking report, unanimously approved by the Board of Directors, 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. LSC-funded programs completed almost 900,000 cases last year—a fraction of the need.

The Justice Gap Report documents that nationwide, for every person helped by LSC-funded programs, another is turned away. Fifty percent of those eligible for assistance and actually seeking help are turned away for one primary reason: lack of resources. If anything, this finding is an understatement. Many who are eligible for help never seek it—they do not know they have a legal problem, do not know help is available, or do not know where to go for help. Moreover, the analysis for the Justice Gap Report was completed before Hurricane Katrina simultaneously swelled the need for civil legal aid and the number of people without access to it.

State legal needs studies conducted in the last year have found that the unmet need for civil legal assistance for poor people ranges from 68 percent in parts of Tennessee to 92 percent in West Virginia, and that 99 percent of defendants in eviction cases in New Jersey and the District of Columbia go to court without a lawyer. The most recent state legal needs studies, conducted in Utah and Wisconsin, document an unmet need of at least 80 percent; this is consistent with the state legal needs studies cited in the Justice Gap Report.

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. As Supreme Court Justice Lewis Powell said, "Equal justice under law is not merely a caption on the façade of the Supreme Court building. It is perhaps the most inspiring ideal of our society . . . it is fundamental that justice should be the same, in substance and availability, without regard to economic status." 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 2007, 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 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, LSC's Treasurer/Comptroller, Chief Administrative Officer, and President evaluate budgets that are prepared by the Office Directors to begin the year and make necessary adjustments to ensure that plans are in accordance with strategic directions. Each month, Office Directors review their monthly activities and expenditures, and quarterly adjustments are made to ensure that strategic initiatives are funded to the maximum amount possible.

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.

Delivery of Legal Assistance

Table 3 provides the budget, expenditure, and variance information for the Delivery of Legal Services. 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 represent two grantee service areas: the California Rural Legal Assistance is on month-to-month funding due to compliance issues; and the funding for American Samoa was terminated on March 15, 2007 for U'Unai Legal Services Clinic, due to compliance issues. 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. No awards were made this year; the full amount of funds available in FY 2007 remains available for future grants and is included with the Reserved Fund Balance.

Table 3
Program Budget Versus Actual Expenditures

	Budget	Expenditures	Variance
Basic Field Programs	$ 330,913,146	$ 328,276,432	$ 2,636,714
U.S. Court of Veterans Appeals	1,288,005	1,270,429	17,576
Technology Inititatives	2,455,617	2,446,012	9,605
Loan Repayment Assistance Program	997,327	201,619	795,708
Grants From Other Funds	228,799	0	228,799
Total	$ 335,882,894	$ 332,194,492	$ 3,688,402

For budgeting purposes and full reporting to LSC's Board of Directors (Board) and the public, there is a slight reporting difference between the management discussion and analysis tables, which are derived from the monthly interim financial reports, and the annual financial statement. The Program budget versus expenditures shown above reports grant expenditures of $331,992,873 (exclusive of the Loan Repayment Assistance Program, which is not a grant program) and the Statement of Activities reports grant expenditures of $331,373,708; the difference is $619,165. This is the amount of FY 2007 Grant Recoveries and this total is shown during the year as revenue earned 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 5 – Grants and Contract Expense.

FY 2007 Management and Administration Analysis and Activity Highlights

Table 4 presents a comparison of the original and final revised operating budget for Management and Administration.

Table 4
Management & Administration
Original and Revised FY 2007 Operating Budget

Budget Category	Original Budget	Final Budget	Increase (Decrease)
Compensation and benefits	$ 10,179,351	$ 9,738,726	$ (440,625)
Temporary employee pay	195,700	155,650	(40,050)
Consulting	707,825	1,017,975	310,150
Travel and transportation expenses	670,725	690,325	19,600
Communications	146,300	166,550	20,250
Occupancy cost	1,672,800	1,671,200	(1,600)
Printing and reproduction	112,100	119,850	7,750
Other operating expenses	547,000	661,600	114,600
Capital expenditures	150,000	159,925	9,925
Total	$ 14,381,801	$ 14,381,801	$ 0

As a result of the quarterly expenditure reviews, internal budgetary adjustments were made to increase consulting, travel, communications, printing, other operating expenditures, and capital expenditures to more closely align to this year's strategic initiatives. These funds were available through savings in personnel compensation and benefits due to unfilled positions, temporary employee pay, and in occupancy cost.

In fiscal year 2007, the Legal Services Corporation:

- Assessed the performance of 49 programs to ensure that they are delivering high quality services in Alabama, Alaska, American Samoa, Arizona, Arkansas, California, Colorado, Connecticut, District of Columbia, Florida, Iowa, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Oklahoma, Minnesota, Mississippi, Missouri, New Hampshire, New Jersey, New York, Ohio, Pennsylvania, South Carolina, South Dakota, Texas, Virgin Islands, Virginia, Washington, Wisconsin and Wyoming. After program visits, the Office of Program Performance (OPP) provides feedback that includes findings and recommendations. OPP staff follows up on progress on significant recommendations.

- Conducted on-site compliance reviews of 23 programs – to ensure they are complying with the Legal Services Act, LSC regulations, and Congressional restrictions – in North Dakota, Wyoming, Georgia, Virginia, Arizona, Florida, Michigan, California, Ohio, Alabama, Pennsylvania, Iowa, New Jersey, Nevada, Georgia, Maryland, Arkansas, Massachusetts, Washington, Colorado, Wisconsin, American Samoa, and the U.S. Virgin Islands. After reviewing a program, the Office of Compliance and Enforcement (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. In conjunction with its complaint investigation responsibilities, OCE initiated a multi-week review of a program in California. In addition to performing compliance reviews, OCE requires that programs seek prior approval for certain expenditures and activities, and also conducts training.

- Evaluated 72 proposals for 2008 grants for service areas in 27 states, American Samoa, the District of Columbia, and Puerto Rico, including multiple proposals for selected service areas in Alabama. LSC will announce 2008 grant awards in December 2007. The review of applications is based on the LSC Performance Criteria and on the other standards listed in 45 CFR Part 1634.

- Revised the LSC Performance Criteria, the centerpiece of LSC's quality initiative. A revised version of the Performance Criteria that includes citations to the ABA's Standards for the Provision of Civil Legal Aid was sent to each staff member and board member of LSC-funded programs. This year, LSC's quality visit reports track the Performance Criteria as does LSC's best practices Web site, www.lri.lsc.gov . The request for proposal narrative for the FY 2009 competition will also reflect the structure and content of the Performance Criteria.

- Awarded 38 new Technology Initiative Grants totaling over $2.4 million, including approximately $321,000 in matching funds provided by the State Justice Institute for 7 joint projects focused on *pro se* access. 56 percent of the funds are going to *pro se* initiatives and 16 percent to Web sites; the remaining 28 percent will be used for training, technical assistance, intake systems, and infrastructure upgrades.

- Continued the Pilot Loan Repayment Assistance Program to assist programs to recruit and to retain recent law school graduates. This year, the second year of the pilot project, 70 attorneys in 24 programs received $5,000 loans.

- Concluded its Leadership Mentoring Pilot Program. The Pilot Program paired 10 mentors with 10 protégés in order to support a well-trained and diverse corps of future leaders within the legal services community. The participants were involved in several training events and activities throughout the Pilot Program. LSC is completing an evaluation regarding the effectiveness of the Pilot Program and examining various leadership mentoring models.

- Completed the update of the Case Service Reporting System and its accompanying Handbook, which defines data elements, such as what programs may count as a "case." The revised Handbook, which will go into effect on January 1, 2008, was officially released on August 3, 2007. Since its release, OCE staff has conducted numerous in-person trainings at local, state, regional, and national training sites. The goal is to train as many program staff as possible before the Handbook's effective date to ensure that LSC-funded programs provide consistent data that accurately reflects the nature and scope of their work.

- Continued disaster response efforts that include bi-weekly conference calls and updating of the disaster assistance website. LSC successfully has coordinated at the national level with the Federal Emergency Management Agency (FEMA), the American Red Cross, and the American Bar Association this year.

- Began the implementation stage of the Board of Directors' initiative to enhance pro bono partnerships between LSC-funded programs and the private bar based on the input of large firms, corporate counsel, small firms and solo practitioners, and law schools. The LSC Board of Directors passed a resolution supporting pro bono activities; many programs have followed suit with their own resolutions. The private attorney involvement section of the LSC Resource Information website, www.lri.lsc.gov has been expanded to include descriptions of many new PAI projects.

During FY 2007, LSC President Helaine M. Barnett and Board Chairman Frank S. Strickland issued the following statement regarding the Government Accountability Office Report, *Legal Service Corporation Governance and Accountability Practices Need To Be Modernized and Strengthened*: "We take the GAO's report on LSC governance and accountability very seriously and are moving diligently to implement the report's recommendations with regard to both governance and management." In response to the report, LSC management has:

- Reviewed the Governmental Accounting Standards Board (GASB) standards to determine the appropriate financial reporting standard for LSC. The Board received Management's report and decided to continue to use the GASB financial reporting standard.

- Adopted elements of a Continuity of Operations Plan program. A comprehensive program is expected to be completed during 2008.

- Established a task force to develop proposals for an LSC compliance program, which will include a comprehensive code of conduct. The goal is to have recommendations to the Board of Directors by the January 2008 Board meeting.

- Committed to improving the risk management program at LSC. The Corporation has managed its risks well over the past 33 years, and will review and implement additional elements that are desirable and appropriate for an organization the size of LSC.

LSC's Board of Directors, in response to the report, will be moving forward to implement the recommendations to the Board in FY 2008.

Table 5 presents the final M&A budget and expenditures for FY 2007, as well as the budget category variances. Over half of the total variance is attributable to personnel compensation and benefits for positions that were vacant during FY 2007.

Table 5
Management & Administration
Operating Budget versus Actual Expenditures

Budget Category	Final Budget	Expenditures	Variance
Compensation and benefits	$ 9,738,726	$ 9,183,891	$ (554,835)
Temporary employee pay	155,650	137,738	(17,912)
Consulting	1,017,975	839,074	(178,901)
Travel and transportation expenses	690,325	620,031	(70,294)
Communications	166,550	143,763	(22,787)
Occupancy cost	1,671,200	1,658,791	(12,409)
Printing and reproduction	119,850	104,115	(15,735)
Other operating expenses	661,600	628,400	(33,200)
Capital expenditures	159,925	115,422	(44,503)
Total	$ 14,381,801	13,431,225	(950,576)
Depreciation and amoritzation		256,070	256,070
Loss on disposal of assets		5,306	5,306
Less: Capitalized assets		(115,422)	(115,422)
		$ 13,577,179	$ (804,622)

FY 2007 OIG Budgetary Analysis and Activity Description

The OIG has two principal duties, 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 oversight responsibility to ensure the quality and integrity of the financial and compliance audits performed by independent public accountants (IPAs). The OIG also conducts on-site reviews of grantees as appropriate. To accomplish its mission, the OIG adopted its own multi-year strategic plan for the years 2007-2011 and an annual work plan. In August 2007, Kirt West left his position as the LSC Inspector General and the Board of Directors appointed Ronald Merryman as the Acting Inspector General. The Board of Directors is moving to select a permanent replacement.

The FY 2007 OIG budget funded reviews of both external grant recipients and IPAs, and internal LSC management operations and activities. Externally focused projects included the review of 138 grantee audit reports and the referrals of significant findings to LSC management for resolution, audit quality reviews of the IPAs' grantee audits, and investigations related to compliance, theft or embezzlement of grantee funds. While investigating a complaint at U'Unai Legal Services Clinic in American Samoa, serious program management concerns were identified by an OIG audit and investigative team, contributing to LSC management's decision to terminate funding to the organization. Additionally, the OIG continued involvement in two important litigation efforts: seeking subpoena enforcement in support of an investigation of LSC grantee California Rural Legal Assistance's violations of Congressional restrictions; and, participating in the discovery phase of a lawsuit challenging LSC's program integrity regulation.

Funded projects with an internal LSC management focus included the review of LSC's Office of Program Performance, oversight of the FY 2006 LSC corporate audit, investigation of statements made to Congress, comments on significant LSC regulatory and policy initiatives, advising the LSC Compliance workgroup and a review of the OIG confidential expenditures program. In order to avoid duplication and ensure effective coordination as required by the IG Act, the OIG worked with the Government Accountability Office (GAO) in its reviews of corporate governance and grants management at LSC. The following projects were still in process at the end of the year: an audit of LSC's Office of Information Management, a few audit service reviews, an audit of Puerto Rico Legal Services, Inc., a survey of personal and private information security, several open investigations and a review of OIG internal controls.

The OIG budget presentation in Table 6 presents a comparison of the original and final operating budget for FY 2007. During the year, only minimal reallocations of monies across the budget categories took place in order to increase funding for the other operating expenditures and communications categories by reducing consulting, and printing and reproduction lines.

Table 6
Office of Inspector General
Original and Revised FY 2007 Operating Budget

Budget Category	Original Budget	Final Budget	Increase (Decrease)
Compensation and benefits	$ 2,894,475	$ 2,894,475	$ 0
Temporary employee pay	25,000	25,000	0
Consulting	188,305	180,505	(7,800)
Travel and transportation expenses	139,000	139,000	0
Communications	16,000	16,750	750
Occupancy cost	1,000	1,000	0
Printing and reproduction	4,200	3,650	(550)
Other operating expenses	26,500	34,100	7,600
Capital expenditures	60,000	60,000	0
Total	$ 3,354,480	$ 3,354,480	$ 0

Table 7 presents the OIG's FY 2007 final budget, expenditures and budget category variances. The expenditure variances from the budget resulted from an unanticipated and significant increase of the OIG appropriation coming in the fifth month of the fiscal year and the time required to produce and enact a responsible spending and hiring plan. After hiring several new staff, the OIG still had two unfilled positions and, in addition, experienced the unexpected departure of the Inspector General and an investigator in the fourth quarter. The late appropriation and the time needed to fill open positions, train new staff and to plan the renovation of existing office space to accommodate for the larger staff size resulted in variances in the consulting, travel and capital expenditure categories.

Table 7
Office of Inspector General
Operating Budget versus Actual Expenditures

Budget Category	Final Budget	Expenditures	Variance
Compensation and benefits	$ 2,894,475	$ 2,320,970	$ (573,505)
Temporary employee pay	25,000	0	(25,000)
Consulting	180,505	34,940	(145,565)
Travel and transportation expenses	139,000	94,578	(44,422)
Communications	16,750	16,542	(208)
Occupancy cost	1,000	0	(1,000)
Printing and reproduction	3,650	2,021	(1,629)
Other operating expenses	34,100	29,082	(5,018)
Capital expenditures	60,000	37,186	(22,814)
Total	$ 3,354,480	2,535,319	(819,161)
Depreciation and amoritzation		0	0
Loss on disposal of assets		0	0
Less: Capitalized assets		(37,186)	(37,186)
		$ 2,498,133	$ (856,347)

Capital Assets and Long-term Debt

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

Table 8
Capital Assets

	2007	2006
Furniture and Equipment	$ 367,185	$ 451,474
Software	79,970	84,085
Leasehold Improvements	130,683	151,046
Total Capital Assets (net)	$ 577,838	$ 686,605

Future Events

Fifty million Americans are eligible for civil legal assistance, including 13 million children. The civil legal aid provided by LSC grantees helps the most vulnerable members of society: women seeking protection from abuse, mothers trying to obtain child support, families facing foreclosure and homelessness, veterans who have been denied health and disability benefits, and elderly people who have been exploited by predatory lenders. The issues involved threaten not just the economic and personal survival of an individual, but the fabric of society as a whole.

In January 2006, the Board of Directors of the Legal Services Corporation adopted a blueprint for the future, *Strategic Directions 2006-2010.* This five-year plan has 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. Using these strategic goals, LSC continues to work to address the justice gap.

The OIG provides the LSC and Congress with independent and objective assessments of opportunities to be more successful. In pursuit of the OIG Strategic Plan's goals and objectives, the OIG will perform audit, evaluation and investigative activities in 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 its own reviews of grantees compliance, conduct the investigation and hotline function, and evaluate the effectiveness and efficiency of LSC, and its grant recipient operations.

The Omnibus Appropriation Act, HR 2764, is expected to be signed into law, by President Bush. This appropriation would provide LSC with $350,490,000 for FY 2007 operations; an increase of $1,912,000 over the FY 2006 appropriation. As of December 21, 2007, LSC was operating under a continuing resolution at FY 2007 appropriation levels. The continuing resolution expires December 31, 2007, at which time the appropriation will have to be approved or another continuing resolution passed.

For fiscal year 2009, the Board has requested $471,362,000 million. This budget increase would be used to increase field grants for LSC-funded programs, enabling them to serve tens of thousands of additional low-income Americans.

Basic Financial Statements

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Excess of revenues over expenditures			$	646,586
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.				(108,767)
Change in net assets			$	537,819
	Fund balance:			
	Beginning of year	$ 3,762,138		
	Net change	646,586		
	End of year	4,408,724	$	4,408,724
To include capital assets (net) used in governmental activities in the statement of activities, which are not reported in fund financial statements				
	Excess of revenues over expenditures	(646,586)		
	Change in net assets	537,819		
	Capital assets, beginning	686,605		
	Capital assets (net)	$ 577,838		577,838
Total net assets			$	4,986,562

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

Legal Services Corporation
Statement of Activities And Governmental Fund Revenues, Expenditures, and Changes in Fund Balance
Year ended September 30, 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
	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	1,257,084		1,257,084
State Justice Institute	318,867		318,867
Change in deferred revenue	1,066,961		1,066,961
	329,220,896	-	329,220,896
General Revenues			
Interest and other income	316,797		316,797
	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

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

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

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

1. Summary of Significant Accounting Policies

Reporting Entity

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

Financial Statement Presentation

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

GASB Statement No. 34 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.

Basis of Accounting

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

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

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

Cash and Cash Equivalents

LSC's cash and cash equivalents includes a fund balance with U.S. Treasury of $32,989,241 and $33,120,904 at September 30, 2007 and 2006, respectively.

Property and Equipment

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

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

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

Fund Balance / Net Assets
The Board of Directors, through its fund allocation process, has designated $1,026,656 and $1,278,920 of the fund balance for continuing programs and administrative activities as of September 30, 2007 and 2006, respectively. Net assets are reported as restricted due to constraints imposed for their use by Congressional appropriation legislation.

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

LSC records a Grant Recovery Receivable when it is probable that LSC will require a grantee to return all or a portion of resources already received, in the amount LSC is expected to reclaim. As of September 30, 2007 and 2006, grant recovery receivables totaled $450,000 and 0, respectively. No allowance for uncollectible receivables has been recorded, as Management deems these fully collectible.

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

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

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

2. Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a bank failure, LSC's deposits may not be returned to it. LSC invests cash balances in excess of predefined target balances through repurchase agreements with two financial institutions. As of September 30, 2007, $15,335,184 of LSC's bank balance of $34,011,625, and 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:

	2007	2006
Uninsured and uncollateralized	$ -0-	$ -0-
Uninsured and collateral held by pledging bank's trust department not in LSC's name	15,335,184	11,987,538
Total	$ 15,335,184	$ 11,987,538

3. Equipment

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

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

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 depreciation	1,580,774	280,317	(40,230)	1,820,861
Capital assets (net)	$ 695,873	$ (8,707)	$ (561)	$ 686,605

Depreciation expense for the years ended September 30, 2007 and 2006 are $256,070 and $280,317, respectively.

4. Grant Revenue

LSC was awarded grants from the U.S. Court of Veterans Appeals for the purpose of furnishing legal assistance to veterans. Grant revenues for the years ended September 30, 2007 and 2006, total $1,260,000 and $1,257,084, respectively.

In addition, LSC was awarded grants from the State Justice Institute, a nonprofit organization established by Federal law, for the purpose of funding LSC's technology initiative grants. Grant revenues for the years ended September 30, 2007 and 2006 total $336,379 and 318,867, respectively.

5. Grant and Contracts Expense

Grant funding provided to the Legal Services Corporation, pursuant to Public Law 110-5, was for basic field programs. Grant and contracts expense for the years ended September 30, 2007 and 2006, consists of the following:

	2007	2006
Basic field programs	$ 328,276,432	$ 310,043,596
U.S. Court of Veterans Appeals fund	1,270,429	1,257,084
Technology Initiatives	2,446,012	2,752,445
Grant recoveries	(619,165)	(139,500)
Totals	$ 331,373,708	$ 313,913,625

6. Retirement Plans

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

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

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

Eligible employees may contribute up to 5% of their pretax earnings to the Federal Thrift Savings Plan. Also, all officers and employees hired after September 30, 1988 are ineligible for the Civil Service Retirement System, but are eligible to participate in LSC's pension and thrift plan, which is a tax deferred annuity plan subject to Section 403(b) of the Internal Revenue Code. Individuals can make contributions 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, 2007 and 2006 were $736,933 and $719,605, 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.

7. Leases

Related Party Lease

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

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

			Amount
September 30,	2008	$	1,710,000
	2009		1,710,000
	2010		1,710,000
	2011		1,710,000
	2012		1,710,000
	2013		1,140,000
	Total	$	9,690,000

Rental expense for the years ended September 30, 2007 and 2006 is $1,710,000 each year. No amounts are due to or from FoLSC at September 30, 2007 and 2006.

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
2008	$	65,044
2009		66,323
2010		55,471
Total	$	186,838

Total sublease income in fiscal year 2007 and 2006 is approximately $54,681 and $53,609, respectively, and is reported as a reduction of rental expense in the accompanying financial statements.

8. Contingencies

Grants and Contracts

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

Claims

A former LSC employee and LSC are discussing the terms of separation. After separation, the former employee alleged some employment-related claims, which LSC considers to be entirely without merit. LSC believes that, any costs in this matter will be insignificant to the financial statements. No funds have been recorded in the financial statements for any contingent liability in connection with this matter.

One of LSC's insurance carriers has refused to provide coverage for LSC's defense costs in two matters currently in litigation. LSC has incurred significant attorney's fees and costs in defending itself in the two matters currently in litigation and intends to pursue the insurance carrier for reimbursement of those expenditures. While it would be in both LSC and the carrier's best interests to resolve the coverage dispute without litigation, LSC has retained pro bono counsel to negotiate and, if necessary, litigate the coverage dispute, and is very hopeful of recovering all or at the very least a substantial portion of the funds expended in its defense of the underlining actions. No funds have been recorded in the financial statements for any contingent liability because this coverage dispute does not present a liability for LSC. If LSC were wholly unsuccessful in the coverage dispute, it would simply not be reimbursed for expenses it has already paid in connection with the underlying actions for which the carrier has denied insurance coverage.

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, 2007 and 2006, participating attorneys received loans totaling $348,919 and $167,013, respectively, and have been reflected as receivables in the accompanying statements of net assets and governmental fund balance sheets. Additional loans were provided in the first quarter of FY 2007 that were attributed to the 2006 program; the 2006 loans forgiven in FY 2007 totaled $201,619. Interest on the loans accrues at six percent per annum. Each loan and the related interest is to be forgiven provided that the participating attorneys successfully complete employment within the loan terms. No provision has been made in the accompanying financial statements to reflect any loss that may occur. No interest on the loans has been accrued as Management has deemed these amounts to be immaterial.

Compliance with LSC Act

In 2007, an internal review of LSC's locality pay program for LSC employees raised a question as to whether an employee's compensation, when locality pay was added to the base salary, could exceed the statutory pay cap set out in the LSC Act. In July of 2007, LSC suspended paying any locality pay that would place an employee's compensation above the cap in the LSC Act until Congress clarified the issue. A provision in the Appropriations Act to clarify the issue and authorize LSC to continue its locality pay program passed Congress and is expected to be signed into law in December 2007. A total of $104,350 in compensation that was not paid during 2007 will become due to 17 LSC employees, upon approval by the Board.

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Report On Internal Control over Financial Reporting and On Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

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

We have audited the financial statements of the Legal Services Corporation as of and for the year ended September 30, 2007 and have issued our report thereon dated December 21, 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 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a certain deficiency in internal control over financial reporting that we consider to be a significant deficiency.

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. However, we believe the following significant deficiency in internal control over financial reporting to be a material weakness, as defined above.

During FY 2007, LSC entered into a settlement agreement with a former grantee for the recovery of grant funds in the amount of $450,000. These funds were received and recorded in early FY 2008 on a cash basis. However, generally accepted accounting principles requires that the asset (receivable) and related revenue (or reduction in expense) be recorded when it is probable that LSC will require the recipient to return funds in the amount LSC is expected to reclaim. An audit adjustment was required to properly accrue this transaction as of September 30, 2007 and adjust the FY 2007 financial statements. Because this transaction is not a routine LCS transaction, internal control procedures have not been designed to ensure non-routine or unusual transactions are correctly recorded. We recommend that LSC develop procedures to ensure that these types of transactions are carefully reviewed against relevant accounting principles to ensure they are properly recorded.

Management concurs with this finding and has implemented a new procedure to ensure that all settlement agreements are forwarded to the Office of Financial and Administrative Services as soon as they are signed, to ensure proper accounting treatment.

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*.

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

We also noted certain matters that we reported to management of LSC in a separate letter dated December 21, 2007

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

Withum Smith+Brown, PC

December 21, 2007