Office of Inspector General
Legal Services Corporation

Inspector General
Jeffrey E. Schanz

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MEMORANDUM

TO: Board of Directors
Legal Services Corporation

FROM: Jeffrey E. Schanz
Inspector General

SUBJECT: Transmittal of FY 2011 Financial Statement Audit Report

DATE: January 19, 2012

The Office of Inspector General (OIG) contracted with the independent certified public accounting firm of WithumSmith+Brown, PC (WS+B) to audit the financial statements of the Legal Services Corporation (LSC) as of September 30, 2011. The audit was required to be conducted in accordance with auditing standards generally accepted in the United States of America, as well as the standards applicable to financial audits contained in the *Government Auditing Standards,* issued by the Comptroller General of the United States.

The Independent Auditor's Reports by WS+B on LSC's financial statements and Internal Control Over Financial Reporting and On Compliance and Other Matters were dated January 9, 2012. The OIG received the final reports from the Independent Auditor on January 18, 2012.

The Independent Auditor's Report by WS+B stated that LSC's financial statements present fairly, in all material respects, the financial position of LSC as of September 30, 2011, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters identified no material weaknesses in internal control and no reportable noncompliance with laws and regulations. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

However, WS+B identified a certain deficiency in internal control over financial reporting, described in the report's Schedule of Finding and Response as Item 11-1, that WS+B considered to be a significant deficiency in internal control over financial reporting. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

The OIG reviewed the audit reports from WS+B and related audit documentation and inquired of their representatives. OIG's review disclosed no instances in which WS+B did not comply, in all material respects, with U.S. generally accepted government auditing standards. Our review, as differentiated from an audit in accordance with generally accepted government auditing standards, was not intended to enable us to express, and we do not express, opinions on LSC's financial statements, conclusions about compliance with applicable laws and regulations, or the effectiveness of internal controls. WS+B is responsible for the attached auditor's reports, dated January 9, 2012, along with the conclusions expressed in the reports.

As part of the audit, the OIG is transmitting a management letter prepared by the Independent Auditor that addresses the audit timeline. The letter states that the completion of a timely annual audit requires greater coordination between LSC management, the Board, and the OIG to ensure that audit timelines are realistic and achievable, and that agreed-upon timeframes are met.

Attachments

cc: James J. Sandman
President

WithumSmith+Brown
A Professional Corporation
Certified Public Accountants and Consultants

Legal Services Corporation

Financial Statements

September 30, 2011

With Independent Auditors' Report

Legal Services Corporation
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September 30, 2011

WithumSmith+Brown
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Independent Auditors' Report

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

We have audited the accompanying statement of financial position of Legal Services Corporation ("LSC") as of September 30, 2011, and the related statements of activities and change in net assets, and cash flows for the year then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and 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 the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of LSC as of September 30, 2011, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated January 9, 2012, on our consideration of LSC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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 considered in assessing the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements as a whole. The accompanying Management's Discussion and Analysis is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

Withum Smith+Brown, PC

Silver Spring, Maryland
January 9, 2012

Basic Financial Statements

Legal Services Corporation
Statement of Financial Position
September 30, 2011

Assets	
Current Assets	
Cash and cash equivalents	$ 80,128,158
Accounts receivable, net	16,473
Prepaid expenses and deposits	174,875
Total current assets	80,319,506
Property and equipment, net	754,240
	$ 81,073,746
Liabilities and Net Assets	
Current Liabilities	
Grants and contracts payable	$ 64,187,855
Accounts payable	968,328
Accrued vacation and other liabilities	1,225,290
Deferred revenue	6,674,663
Total current liabilities	73,056,136
Net assets	
Unrestricted	
Undesignated	6,395,222
Board designated	855,648
Net investment in fixed assets	754,240
Total unrestricted	8,005,110
Temporarily restricted	12,500
Total net assets	8,017,610
	$ 81,073,746

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

Legal Services Corporation
Statement of Activities and Change in Net Assets
Year Ended September 30, 2011

	Unrestricted	Temporarily Restricted	Total
Support and Revenues			
Federal appropriations	$ 404,190,000	$ -	$ 404,190,000
Grant revenue	2,315,360		2,315,360
Interest	1,561		1,561
Other income	12,019	12,500	24,519
Donated services	67,145		67,145
Change in deferred revenue	(718,856)		(718,856)
Total Revenue	405,867,229	12,500	405,879,729
Expenses			
Program services			
Grants and contracts	383,027,214		383,027,214
Herbert S. Garten Loan Repayment Assistance Program	1,517,646		1,517,646
Supporting services			
Management and grants oversight	16,907,199		16,907,199
Office of Inspector General	4,038,712		4,038,712
Total Expenses	405,490,771		405,490,771
Change in net assets	376,458	12,500	388,958
Net assets, beginning of year	7,628,652		7,628,652
Net assets, end of year	$ 8,005,110	$ 12,500	$ 8,017,610

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

Legal Services Corporation
Statement of Cash Flows
Year Ended September 30, 2011

Cash flows from operating activities		
Change in net assets	$	388,958
Adjustments to reconcile changes in net assets		
to net cash provided by operating activities:		
Depreciation and amortization		225,917
Loss on disposal of assets		268
Changes in assets and liabilities:		
Accounts receivable		303
Prepaid expenses and deposits		205,669
Grants and contracts payable		(5,243,455)
Accounts payable		610,019
Accured vacation and other liabilities		213,641
Deferred revenue		718,856
Net cash used by operations		(2,879,824)
Cash flows from investing activities		
Purchase of property and equipment		(588,429)
Net cash used by investing activities		(588,429)
Net decrease in cash and cash equivalents		(3,468,253)
Cash and cash equivalents		
Beginning of year		83,596,411
End of year	$	80,128,158
Supplemental information		
Income taxes paid	$	-0-
Interest paid	$	-0-

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

1. Organization and Purpose

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.

2. Summary of Significant Accounting Policies

Basis of Accounting

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

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

Basis of Presentation

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

LSC has recorded transactions in the following net asset categories:

Unrestricted net assets – net assets that are not subject to donor imposed restrictions.

Temporarily restricted net assets – Net assets subject to donor imposed restrictions that will be met by the passage of time or which will be fulfilled by the actions of LSC.

Cash and Cash Equivalents

LSC's cash and cash equivalents includes a fund balance with U.S. Treasury of $44,411,646.

Accounts Receivable

Accounts receivable are net of an allowance of $1,113,777 at September 30, 2011, determined based on historical experience and an analysis of specific amounts.

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.

Revenues

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

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.

Grant Recoveries
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. Grant recoveries are reported as a reduction of grant and contract expenses on the accompanying statement of activities.

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

The Board of Directors, through its fund allocation process, has designated $855,648 of the fund balance for continuing programs and administrative activities as of September 30, 2011. Net assets are reported as restricted due to donor stipulations that limit the use of the donated asset.

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. No provision for income taxes was required for the year ended September 30, 2011, as LSC had no net unrelated business income.

LSC evaluates its uncertain tax positions using the provisions of FASB ASC 450, Accounting for Contingencies. Accordingly, a loss contingency is recognized when it is probable that a liability has been incurred as of the date of the financial statements and the amount of the loss can be reasonably estimated. The amount recognized is subject to estimates and management judgment with respect to the likely outcome of each uncertain tax position. The amount that is ultimately sustained for an individual uncertain tax position or for all uncertain tax positions in the aggregate could differ from the amount recognized. There were no liabilities for uncertain tax positions as of September 30, 2011. There was also no tax-related to interest and penalties reported in the financial statements.

LSC's Forms 990, Return of Organization Exempt from Income Tax, for the years ending September 30, 2008, 2009 and 2010 are subject to examination by the IRS, generally for 3 years after they were filed.

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

3. Concentration of Credit Risk – Deposits

At September 30, 2011, LSC funds are in non-interest bearing accounts. LSC's cash accounts are subject to Federal Deposit Insurance Corporation (FDIC) limits. Non-interesting bearing accounts are fully insured by the FDIC through December 31, 2012.

4. Equipment

Property and equipment consists of the following at September 30, 2011:

	Beginning Balance	Additions	Disposals	Ending Balance
Furniture and equipment	$ 1,939,453	$ 423,506	$ (53,008)	$ 2,309,951
Software	406,050	60,973	-	467,022
Leasehold improvements	351,698	103,949	-	455,647
Subtotal	2,697,201	588,428	(53,008)	3,232,620
Less: Accumulated depreciation /amortization	(2,305,205)	(225,917)	52,741	(2,478,380)
Capital assets (net)	$ 391,996	$ 362,511	$ (267)	$ 754,240

Depreciation/amortization expense for the year ended September 30, 2011 is $225,917.

5. Grant Revenue

LSC was awarded a grant from the U.S. Court of Veterans Appeals for the purpose of furnishing legal assistance to veterans. Grant revenues for the year ended September 30, 2011, total $2,315,360.

6. Grants and Contracts Expense

Grants and contracts expense for the year ended September 30, 2011 consists of the following:

	2011
Basic Field Programs	$ 377,892,573
U.S. Court of Veterans Appeals	2,311,575
Grant From Other Funds	111,409
Technology Inititatives	2,903,326
Grant Recoveries	(191,669)
Total	$ 383,027,214

7. Management and Grants Oversight

Management and grants oversight expenses for the year ended September 30, 2011 were as follows:

		2011
Compensation and benefits		$ 12,157,984
Temporary employee pay		507,879
Consulting		618,469
Travel and transportation		800,518
Communications		106,815
Occupancy cost		1,730,590
Printing and reproduction		62,706
Other operating expenses		696,319
Capital expenditures		515,182
	Total	17,196,462
Depreciation & Amortization		225,917
Loss on disposal of assets		268
Less: capitalized assets		(515,448)
		$ 16,907,199

8. Office of Inspector General

LSC's Office of Inspector General expenses for the year ended September 30, 2011 were as follows:

		2011
Compensation and benefits		$ 3,579,686
Temporary employee pay		8,408
Consulting		167,188
Travel and transportation		199,678
Communications		17,331
Occupancy cost		1,482
Printing and reproduction		8,271
Other operating expenses		56,668
Capital expenditures		73,246
	Total	4,111,958
Less: capitalized assets		(73,246)
		$ 4,038,712

9. Retirement Plans

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

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

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

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

LSC's contributions to these plans for the year ended September 30, 2011 were $994,311. The amounts are included in compensation and benefits for management and administration expenses. LSC also offers a tax deferred annuity savings plan for eligible employees. No contributions are made to this plan by LSC.

10. Operating Lease

On June 1, 2003, LSC commenced an operating lease agreement for office space which provides for a non-escalating annual base rent for a 10-year term. LSC 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 as of September 30, 2011 are as follows:

Fiscal Year	Amount
2012	$ 1,710,000
2013	1,140,000
	$ 2,850,000

Rental expense for the year ended September 30, 2011 is $1,710,000.

11. Contingencies

Grants and Contracts

LSC receives its funding from appropriations by Congress and grants from the U.S. Court of Veterans Appeals and, accordingly, may be subject to federal audits. In addition, LSC provides significant funding to numerous independent organizations, which are subject to their own independent audits and audits by

LSC. LSC's management does not expect any significant adjustments as a result of federal audits, should they occur, or from the audits of the grantees' independent auditors.

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

Claims

LSC is defending what started as two separate cases but have been consolidated into one case involving challenges to LSC regulations. Plaintiffs are seeking injunctive relief but no monetary damages, except for attorneys' fees but LSC's legal fees in these cases were being paid by its insurance carriers. Insurance is no longer available to cover legal fees in this consolidated matter and must be paid directly by LSC out of normal operating funds, without reimbursement by insurance carriers. However, the matter has been dormant since 2009 and no renewed activity is anticipated. No funds have been recorded in the financial statements for any contingent liability associated with future legal fees.

In August of 2011, a civil lawsuit, Wojdak v LSC, U.S. Department of Labor, U.S. Department of the Treasury, was filed against LSC but never served. Although the lawsuit names LSC as a co-defendant, no specific claims were made against LSC. No funds have been recorded in the financial statements for any contingent liability associated with this matter.

Since June of 2011, several employees of LSC have filed wage discrimination complaints with the Equal Employment Opportunity Commission (EEOC). As they were only recently filed, all but one remain pending before the EEOC. Outside counsel for the Corporation has assessed the pending claims and advised that none is meritorious. Given that, in the opinion of counsel, none of these matters poses a reasonable possibility of an unfavorable outcome, no funds have been recorded in the financial statements for any contingent liability associated with these matters.

Reclassification of employees from exempt to non-exempt

No one made a claim against LSC alleging misclassification or failure to pay overtime, but LSC reclassified certain individuals from exempt to nonexempt and retroactively paid wages for hours worked in excess of 37.5 hours per week. Sufficient funds were available to make these payments without affecting current operations. Total amount paid during year ended September 30, 2011 is $9,448 and the amount due at September 30, 2011 is $25,782.

Collection Matters

In 2010, upon concluding that an LSC grantee had misused LSC funds and committed other financial irregularities, LSC disallowed approximately $716,261 of the grantee's costs. On appeal, LSC agreed to reduce that amount to $467,619. In 2011, the grantee was completely defunded. The Corporation is now exploring its options on how to recover the previously disallowed amount of $467,619. No amounts have been recorded.

12. Loan Repayment Assistance Program

Through the Herbert S. Garten Loan Repayment Assistance Program (LRAP), established in 2005 and funded by Congressional appropriations, LSC makes a limited number of forgivable loans to attorneys employed by its grantee programs to help repay law school debt. Each participant receives up to $5,600 per year for three years – for a maximum of $16,800 if they remain eligible and funding remains available.

Participants must commit to remain with the LSC-funded legal services program for three years. As long as the participant remains in good standing, the loans are forgiven. Participants that do not successfully complete employment within the loan terms must repay the loans. No provision has been made in the accompanying financial statements to reflect any interest on the loans as management has deemed these amounts to be immaterial.

Accounts receivable are stated at the amount management expects to collect from refunded loans. Management provides for probable forgiven amounts through an adjustment to a valuation allowance based on its assessment of the current status of individual accounts. Accounts receivable balances are written-off through a charge to the valuation allowance in the year the loans are forgiven. Deferred revenue is comprised of funding available for future loans and loan amounts outstanding.

LRAP balances at September 30, 2011 are as follows:

Cash	$	1,176,638
Accounts receivable, net		7,535
Deferred revenue		1,184,223

LRAP activity for the year ended September 30, 2011 is as follows:

Loans made	$	1,518,607
Loans forgiven		866,953
Net change in allowance for loan forgiveness		650,693

13. Temporarily Restricted Net Asset

LSC received donations totaling $12,500 which are restricted for the American Bar Foundation *Access Across America* research project.

14. Prior Period Adjustment

During the FY 2011 audit, the decision was made to set up an allowance for the Herbert S. Garten Loan Repayment Assistance Program to properly report the Loan Repayment Assistance Program Receivable at its net realizable value in accordance with generally accepted accounting principles. The total amount of the adjustment related to FY2010 was $463,084 causing the accounts receivable to be adjusted from $479,860 to $16,776 on the statement of financial position and the Herbert S. Garten Loan Repayment Assistance Program expense to be adjusted from $572,162 to $990,246 on the statement of changes in net assets. In addition, the adjustment caused the deferred revenue to be adjusted from $6,418,891 to $5,955,807 on the statement of financial position and the change in deferred revenue to be adjusted from $3,619,052 to $3,155,968 on the statement of activities. These changes had no effect on the net assets of LSC at September 30, 2010.

15. Subsequent Events

Legal Services Corporation has evaluated subsequent events occurring after the statements of financial position date through the date of January 9, 2012 the date the financial statements were available for release.

Fiscal Year 2012 Funding

On November 17, 2011, the House and Senate passed the Conference Report (House Report 112-284) to accompany H.R. 2122, an appropriations bill for Fiscal Year 2012 that included $348 million for the Legal Services Corporation. President Obama signed the bill into law (Public Law 112-55) on November 18.

The appropriations bill, popularly known as the “minibus,” combined the Agriculture, Commerce-Justice-Science and Transportation-HUD spending bills. LSC is funded through the Commerce, Justice, Science and Related Agencies Appropriations Subcommittee.

The Fiscal Year 2012 appropriation will provide $322.4 million for basic field grants, $3.4 million for the Technology Initiative Grants program, $1 million for the student loan repayment assistance program, $17 million for management and grants oversight, and $4.2 million for the LSC Office of Inspector General. Prior to enactment, LSC operated on funds provided by a Continuing Resolution (Public Law 112-36) that cut all accounts by 1.5 percent and expired on November 18, 2011. LSC was funded at $398 million under the interim bill.

WithumSmith+Brown
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New York and Pennsylvania

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, 2011 and have issued our report thereon dated January 9, 2012. 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

Management of Legal Services Corporation is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered LSC's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of LSC's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of LSC's internal control over financial reporting.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified a certain deficiency in internal control over financial reporting, described in the accompanying schedule of finding and response as item 11-1 that we consider to be a significant deficiency in internal control over financial reporting. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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 instance of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of LSC in a separate letter dated January 9, 2012.

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

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

Withum Smith+Brown, PC

Silver Spring, Maryland
January 9, 2012

Finding 11-1

Accounting Relating to Loan Repayment Assistance Program (LRAP)

We noted an error relating to the LRAP accounting, which impacts both the FY 2010 financial statements, as well as the FY 2011 statements. This error was the result of a deficiency in the design of controls relating to management's assertion that receivables are properly valued in the financial statements in accordance with generally accepted accounting principles (GAAP). LSC did not have in place a control that was designed to meet this control objective.

FASB ASC 310-10-35-8 Subtopic 450-20 *Losses from Uncollectible Receivables* requires recognition of a loss when both of the following conditions are met:

a. Information available before the financial statements are issued or are available to be issued indicates that it is probable that an asset has been impaired at the date of the financial statements.
b. The amount of the loss can be reasonably estimated.

Losses from uncollectible receivables shall be accrued when both of the preceding conditions are met.

The LRAP provides loan funding to repay student loan debt for individuals who work for LSC grantees and who meet certain eligibility requirements. Applicants must commit to remain with the LSC program for three years. Once the loan to the individual is awarded, if the individual meets certain requirements, LSC will forgive the loan at the conclusion of the loan term.

Since the inception of the program, LSC has made loans in the following amounts:

FY	Amount
2006	$ 167,013
2007	383,525
2008	271,437
2009	552,933
2010	435,061
2011	1,518,607
Total	$ 3,328,576

Beginning in FY 2007, LSC began forgiving loans in the following amounts:

FY	Amount
2007	$ 201,619
2008	324,866
2009	279,400
2010	527,162
2011	866,953
Total	$ 2,200,000

Although prior year loan receivable balances were not determined to be material to the financial statements, at fiscal year-end September 30, 2011, LSC reported accounts receivable related to LRAP at $1,121,362, which was an increase of $650,693 from the prior year, and therefore was flagged as requiring further audit scrutiny. However, this receivable balance was not properly adjusted to reflect management's estimate of the net realizable value. As a result, the accounts receivable balance was overstated, since the direct write-off method was being used rather than the allowance method, which is required by generally accepted accounting principles (GAAP) to more accurately represent future cash flows.

An adjustment was required to properly reflect an allowance in FY 2010 of approximately $463,084, which is management's estimate of the amount that will be forgiven based on prior history. A related adjustment to deferred revenue was also required. In addition, management had also not recorded an allowance in FY 2011. An audit adjustment of approximately $650,693 was required to properly reflect the current year receivable balance of $7,585 with a corresponding entry to deferred revenue.

Although at the inception of the program LSC was not able to estimate how many of the loans would ultimately be forgiven, as it began developing a history of forgiving loans, an estimate could have been developed to adjust the receivable balances to their net realizable value. Management stated that the accounting treatment used was in concurrence with discussions with the prior auditor. However, management was unable to provide any documentation in support of these discussions or the accounting standards on which the accounting treatment was based.

We recommend that LSC annually evaluate the receivable balance and adjust the allowance account to an appropriate amount based on its assessment of current status of individual accounts. We also recommend management consider using a financial statement preparation and disclosure checklist when it prepares its annual financial statements, which may help to prevent future oversights.

Management's Response

Management's LRAP accounting for both 2010 and 2011 followed the same methodology Management used for all prior years of the LRAP's existence. In each year, Management made and recorded write-downs of the loans outstanding (shown as a receivable) after Management had verified that the loan recipients had met the forgiveness requirements of the program. LSC's financial statements have consistently shown a significant annual reduction in loans receivable as recipients' balances have been forgiven, and the forgiven amounts have been shown as expenses on the Corporation's financial statements. Management discussed this methodology with its auditors in prior years, and they agreed that it was appropriate.

Management agrees that it is appropriate to adjust the loan receivable balances to reflect Management's estimate of the net realizable value. Accordingly, the balances have been adjusted for FY 2010 and FY 2011, and, going forward, Management will adjust the loan receivable balances to reflect its estimate of the amount that will be forgiven based on prior history. Management accepts the recommendation that it will annually evaluate the receivable balance and adjust the allowance account to an appropriate amount based on its assessment of the current status of individual accounts.

Auditors' Evaluation of Management's Response

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

Appendix

Mission

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

Organization

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

LSC is the single largest source of funding for civil legal assistance for low-income individuals and families. LSC currently provides grants to 136 legal services programs, which operate as independent nonprofit organizations with their own boards of directors. Substantially all of the Corporation's funding comes from the Congress, and almost 94 percent of the annual congressional appropriation is distributed to these programs through a competitive grants process. LSC provides oversight, guidance and training to ensure the programs provide high-quality legal services and comply with congressional restrictions, LSC rules and regulations, and grant conditions.

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

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

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

In addition to these offices, LSC has an independent Office of Inspector General (OIG), established by statute in 1989 to conduct and supervise audits, investigations, and reviews to detect and prevent fraud and abuse and to promote economy, efficiency, and effectiveness in LSC's programs and operations. The OIG provides LSC and the Congress with independent and objective assessments of programs and activities, reports on problems and deficiencies and the need for and progress of corrective action, and reviews and makes recommendations with respect to laws and regulations affecting LSC. The OIG is also responsible for oversight of the annual audits of LSC and its grantees, performed by independent public accountants (IPAs), as well as for monitoring grantee compliance with LSC regulations via the IPA audit process and through its own reviews. The OIG is a separate line item in LSC's annual appropriation acts.

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

Access to Justice and Delivery of Civil Legal Assistance

Equal access to justice is a core principle of American democracy. LSC has become the bedrock on which our national system of access to civil justice for low-income Americans stands. The system is also supported by state and local appropriations, Interest on Lawyers' Trust Accounts funds, court filing-fee surcharges, foundation support, and private contributions.

LSC currently awards and oversees grants to 136 independent, nonprofit legal aid programs in every state, the District of Columbia and U.S. territories. Persons eligible for LSC-funded services are at or below 125 percent of the federal poverty line; in 2011, that was an income of $27,938 for a family of four.

More than 60 million Americans are eligible for LSC-funded services, according to the most recent U.S. Census Bureau count for the year 2010. That is nearly one in five Americans, and an increase of 3.6 million people from 2009.

The cases at LSC-funded programs reflect the nation's slow recovery from the 2008 recession. Matters involving foreclosures, landlord-tenant disputes, unemployment, bankruptcy and consumer finance, and domestic violence all increased in 2010 compared to the previous year. Almost all LSC programs reported handling foreclosure cases, and more than 40 LSC programs have established foreclosure units.

In 2010, the year for which the most recent data are available, matters involving family law represented 34.5 percent of cases closed by LSC-funded programs. The next largest category involved housing law, at 25.2 percent of cases closed. Other major case categories were income maintenance and consumer issues, both at about 12 percent. LSC-funded programs closed a total of 932,406 cases in 2010. These cases involved households with about 2.3 million people.

LSC programs are unable to meet the legal needs of all low-income Americans seeking civil legal assistance. Data collected from LSC-funded programs in 2005 and 2009 showed that for every client served by a program, one eligible person who actually sought help was turned away because of insufficient resources.

Despite inadequate resources, LSC programs are resilient and innovative. Starting in 2008, the number of cases closed through the involvement of private attorneys has increased by 16 percent. In 2010, about 11 percent of LSC's total cases were handled by pro bono volunteers and other private attorneys. LSC-funded programs also continue to reach more citizens through websites, and increasing numbers of legal forms and other information are being downloaded every year. For example, Pine Tree Legal Assistance in Maine launched StatesideLegal.org, the first website in the nation to focus exclusively on federal legal rights and resources important to veterans.

Overview of Financial Statements

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

Management's Discussion and Analysis provides an overview of LSC's financial position and results of operations for fiscal years 2011 and 2010 and an overview of the fiscal year 2011 operating budget experience.

Financial Highlights

LSC receives its financial support from a congressional appropriation and its derivative income and a grant from the U.S. Court of Veterans Appeals. Any funds not expended in one fiscal year are carried over into the following fiscal year.

For Fiscal Year 2010, LSC operated under a Continuing Resolution at 2009 funding levels until December 16, 2009, when the President signed into law an appropriation of $420 million. On April 15, 2011, funding for Fiscal Year 2011 was enacted, and LSC funding was reduced to about $404.2 million. Most of the Fiscal 2011 appropriation, about $378.6 million, was designated for basic field grants for the provision of civil legal assistance to low-income Americans.

The following tables show the critical elements of the budgets and their breakdowns for fiscal years 2011 and 2010:

Table 1--For the year ended September 30, 2011

	(1) FY 2011 Appropriations	(2) FY 2011 Funding Reduction & Recission	(3) FY 2010 Carryover	(4) Court of Vets Appeals & Adjustments	(5) FY 2011 Consolidated Operating Budget
I. Delivery of legal assistance					
1. Basic Field Programs	$ 394,400,000	$ (15,758,800)	$ 917,976	$ -	$ 379,559,176
2. US Court of Veterans Appeals Funds	-	-	22	2,315,360	2,315,382
3. Grants From Other Funds	-	-	644,817	-	644,817
4. Technology Initiatives	3,400,000	(6,800)	3,336,613	-	6,729,813
Delivery of legal assistance total	397,800,000	(15,765,600)	4,899,428	2,315,360	389,249,188
II. Management & grant oversight	17,000,000	(34,000)	4,439,926	-	21,405,926
III. Herbert S. Garten loan repayment assistance program	1,000,000	(2,000)	1,701,196	-	2,699,196
IV. Inspector General	4,200,000	(8,400)	2,151,911	-	6,343,511
Total Budget	$ 420,000,000	$ (15,810,000)	$ 13,192,461	$ 2,315,360	$ 419,697,821

Table 1.1--For the year ended September 30, 2010

	(1) FY 2010 Appropriations	(2) FY 2009 Carryover	(3) Court of Vets Appeals & Adjustments	(4) FY 2010 Consolidated Operating Budget
I. Delivery of legal assistance				
1. Basic Field Programs	$ 394,400,000	$ 1,100,413	$ -	$ 395,500,413
2. US Court of Veterans Appeals Funds	-	312	1,820,000	1,820,312
3. Grants From Other Funds	-	832,443	-	832,443
4. Technology Initiatives	3,400,000	7,962	-	3,407,962
Delivery of legal assistance total	397,800,000	1,941,130	1,820,000	401,561,130
II. Management & grant oversight	17,000,000	3,502,693	-	20,502,693
III. Herbert S. Garten loan repayment assistance program	1,000,000	1,691,442	-	2,691,442
IV. Inspector General	4,200,000	1,734,434	-	5,934,434
Total Budget	$ 420,000,000	$ 8,869,699	$ 1,820,000	$ 430,689,699

Table 2
Statement of Financial Position

	September 30	
	2011	2010
Total current assets and other assets	$ 80,319,506	$84,456,815
Net property and equipment	754,240	391,997
Total Assets	81,073,746	84,848,812
Grants and contracts payable	$ 64,187,855	$69,431,311
Other liabilities	2,193,618	1,369,958
Deferred revenue	6,678,448	6,418,891
Total Liabilities	73,059,921	77,220,160
Net Assets		
Undesignated	6,391,437	6,683,210
Designated	855,648	553,445
Net investment in fixed assets	754,240	391,997
Temporarily restricted	12,500	-
Total Net Assets	8,013,825	7,628,652
Total Liabilities and Net Assets	$ 81,073,746	$84,848,812

The financial statements are a series of related reports that detail financial information using accounting methods similar to those used by other not-for-profits. For example, when reviewing the total unrestricted net assets of the Statement of Financial Position, it shows that the total unrestricted assets increased from $7,628,652 to $8,001,325. Table 3 shows that this change in net assets increased $388,958 in fiscal year 2011 and increased $1,163,837 in 2010.

Table 3
Statement of Activities

	Years ended September 30, 2011	2010
Revenue		
Federal appropriations	$ 404,190,000	$ 420,000,000
Grant revenue	2,315,360	1,820,290
General revenues		
Change in deferred revenue	(718,856)	(3,619,052)
Contributed Services	67,145	-
Interest & other income	26,080	17,107
Total revenue	405,879,729	418,218,345
Expenses		
Program activities	384,544,860	396,661,702
Supporting activities	20,945,911	20,392,806
Total expenses	405,490,771	417,054,508
Change in net assets	388,958	1,163,837
Net assets, beginning of year	7,628,652	6,464,815
Net assets end of year	$ 8,017,610	$ 7,628,652

Fiscal Year 2011 MGO Budgetary Analysis and Activity Description

Table 4 presents the final budgets for Management and Grants Oversight (MGO) for Fiscal Years 2011 and 2010.

Table 4
Management and Grants Oversight
Operating Budgets for Years Ending September 2011 and 2010

Budget Category	2011	2010
Compensation and benefits	$ 14,905,225	$ 14,260,725
Temporary employee pay	578,725	188,150
Consulting	1,127,200	1,338,900
Travel & transportation expenses	1,292,850	1,053,900
Communications	177,550	168,000
Occupancy cost	1,759,650	1,718,100
Printing and reproduction	101,150	102,400
Other operating expenses	803,576	1,050,518
Capital expenditures	660,000	622,000
Total	$ 21,405,926	$ 20,502,693

The civil legal services that LSC funds are provided by 136 independent programs with more than 900 offices. LSC exercises oversight of the programs' financial management practices, legal services delivery, and compliance with legal requirements.

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

During Fiscal Year 2011, OPP:

- Conducted full program quality visits to 18 programs and two capability assessments in 16 states and territories to ensure the delivery of high-quality civil legal assistance.
- Performed shorter program evaluation or technical assistance visits to another 19 programs in 17 states and territories to assess grantee activities or to follow-up on prior concerns.
- Evaluated 95 proposals for funding from 62 applicants for 94 service areas in 29 states and territories, including one multiple-applicant area.
- Awarded 37 new Technology Initiative Grants (TIG), totaling more than $3.6 million in 25 states. TIG funded six on-line intake projects to help make program services more accessible to applicants and more efficient. TIG funding also supported expansion of a website for veterans and service members.
- Administered the Herbert S. Garten Loan Repayment Assistance Program (LRAP), which provides forgivable loans to attorneys to help LSC grantee programs recruit and retain highly qualified attorneys. A total of 195 attorneys in 84 programs received loans in FY 2011. Recipients ranged from new hires to attorneys with six years of service with a grantee.

- Provided guidance to LSC-funded programs in more than 28 states preparing for or responding to disasters, hosted four national disaster update and networking calls, and coordinated disaster relief funding for Alabama Legal Services to serve persons affected by the April 27, 2011 tornadoes. OPP staff traveled to Joplin, Missouri to provide technical assistance to Legal Aid of Western Missouri shortly after the May 22, 2011 tornado.

During Fiscal Year 2011, OCE assessed the policies and procedures of grantees for compliance with legal requirements in such areas as client-income eligibility, nature of legal assistance provided, use of non-LSC funds, sub-grants, and various statutory prohibitions.

During Fiscal Year 2011, OCE:

- Conducted 19 Case Service Report/Case Management System (CSR/CMS) reviews, six follow-up reviews, one financial internal controls review, and one audit report follow-up review.
- Reviewed and, as appropriate, acted on 75 audit findings referred by the Office of Inspector General.
- Opened 49 complaints against grantees for violations of the LSC Act, regulations and guidelines, and closed 9 complaints.
- Reviewed and approved 56 sub-grants.
- Reviewed 121 grantee-audited financial statements for fiscal years 2009 and 2010 to ensure compliance with the LSC Accounting Guide.
- Reviewed and approved fund balances at grantees, acting on 13 fund-balance waiver requests.
- Addressed specific concerns regarding grantees, including one intake assessment visit in conjunction with OPP and one fiscal capability assessment in conjunction with OPP.
- Provided CSR training for grantees and training for new Executive Directors, including a technical assistance visit to a newly funded LSC grantee, and fiscal trainings/presentations at two conferences.

The LSC Board of Directors also has focused on the needs of clients and the resource constraints that affect the delivery of legal assistance. The Board has convened panels of Executive Directors to hear directly about priorities in the field and has received presentations on the challenges of delivering legal services in urban, rural and Native American communities.

In 2010, the Board established the Special Task Force on Fiscal Oversight to review LSC's practices and to make recommendations regarding LSC's fiscal oversight of the independent nonprofit legal aid programs that receive LSC grants. The Task Force was co-chaired by the Chairman of the LSC Finance Committee and the Chairman of the LSC Audit Committee. On August 1, 2011, the Task Force presented its report and recommendations to the Board for strengthening the fiscal oversight that LSC exercises. The LSC Board subsequently solicited public comments on the Task Force's report and recommendations and is now considering the comments received and the Task Force's recommendations.

Note 7 under Notes to Financial Statements presents the final expenses for MGO for fiscal year 2011.

Fiscal Year 2010 OIG Budgetary Analysis and Activity Description

In fulfilling the Inspector General duties at LSC the OIG was guided by its own multi-year strategic plan for the years 2007-2011 and led by Inspector General Jeffrey E. Schanz. The OIG prepared this section and it is included without change.

The FY 2011 OIG budget funded reviews of external grant recipients, IPAs, and internal LSC management operations and activities.

External grant recipient and IPA focused projects included:

- Reviews of 137 grantee audit reports with referral of all significant findings to LSC management for resolution;
- Audits of LSC grant recipients including Appalachian Research & Defense Fund of Kentucky, California Indian Legal Services, Colorado Legal Services, Mid-Penn Legal Services, Legal Services of Northern Virginia, and Legal Aid of North Carolina, with an additional five grantee audits in progress at the end of the fiscal year;
- A recently launched program of both routine and targeted quality control reviews (QCRs) designed to provide greater assurance as to the quality of the IPAs' work and identify or respond to potential concerns that may arise with a particular grantee or IPA. Both types are conducted by an independent certified public accounting firm, operating under contract to the OIG. As of the fiscal year end, 13 routine QCRs and 8 targeted QCRs had been completed;
- Investigations and subsequent prosecutions of significant theft or embezzlement of grant recipient funds;
- Investigations related to compliance matters;
- Fraud awareness briefings designed to assist LSC and its grantees in preventing and detecting fraud;
- Proactive fraud alerts, awareness briefings, vulnerability assessments, and related fraud reviews;
- Hotline operation for nationwide reporting of suspected fraud, waste or abuse in recipient programs and LSC;
- Providing an analysis for the Chairman of the House Appropriations Subcommittee on Commerce, Justice, Science, and Related Agencies, regarding possible violation by an LSC grantee of restrictions on political activity;
- Additionally, continued involvement in litigation seeking subpoena enforcement in support of an investigation of an LSC grantee's possible violations of Congressional restrictions.

Projects reviewing selected LSC management operations and activities included:

- An audit of LSC's multi-million dollar Technology Initiative Grant program, identifying a material weakness in the program's internal control system and providing recommendations to strengthen internal controls over the program's operation;
- Oversight of the FY 2010 LSC corporate audit;
- In addition, the OIG participates as a member of the Council of the Inspectors General for Integrity and Efficiency, the official organization of Federal inspectors general, and on its various committees and working groups.

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

The OIG budget presentation in Table 5 contains a comparison of the original and final operating budget for FY 2011.

Table 5
Office of Inspector General
Original and Revised FY 2011 Operating Budget

Budget Category	Original Budget	Final Budget
Compensation and benefits	$ 3,883,891	$ 3,883,891
Temporary employee pay	40,000	40,000
Consulting	893,000	893,000
Travel & transportation expenses	400,000	400,000
Communications	48,700	44,700
Occupancy cost	6,000	6,000
Printing and reproduction	6,000	10,000
Other operating expenses	965,820	965,820
Capital expenditures	100,100	100,100
Total	$ 6,343,511	$ 6,343,511

Table 6 presents the OIG's FY 2011 final budget, expenditures, and budget category variances. The OIG has taken a fiscally prudent approach to expending its increased funding by making incremental increases in OIG operations. The expenditure variances from the budget include: $909,152 in the Other Operating Expenditures line, where the OIG reports carry-over funding related to its multi-year budget plan; $725,812 in the Consulting line, of which $161,006 is committed in consulting contract encumbrances attributed to the stepped-up audit quality control reviews – much of the remainder results from delayed information management and technology investments; $304,205 in Compensation and Benefits, which resulted from three unfilled FY2011 budgeted positions; and $200,322 in the Travel line related to the delayed kickoff of the audit quality control program and the resource allocation dictated by the internal LSC focus of the first phase of the technology initiative grants audit work.

Table 6
Office of Inspector General
Operating Budget versus Actual Expenditures

Budget Category	Final Budget	Expenditures	Variance
Compensation and benefits	$ 3,883,891	$ 3,579,686	$ 304,205
Temporary employee pay	40,000	8,408	31,592
Consulting	893,000	167,188	725,812
Travel and transportation	400,000	199,678	200,322
Communications	44,700	17,331	27,369
Occupancy cost	6,000	1,482	4,518
Printing and reproduction	10,000	8,271	1,729
Other operating expenses	965,820	56,668	909,152
Capital expenditures	100,100	73,246	26,854
TOTAL	$ 6,343,511	$ 4,111,958	$ 2,231,553
Less: capitalized assets		(73,246)	73,246
		$ 4,038,712	$ 2,304,799

Major Challenges

The need for civil legal assistance to low-income Americans has never been greater. Low-income Americans face legal issues involving matters of subsistence, safety, and family stability, and the number of low-income persons in poverty keeps rising. Even before the 2008 recession, studies in several states found that about 80 percent of the legal needs of low-income families go unmet. Increasing numbers of unrepresented litigants are swamping state courts, especially those that deal with housing and family law matters.

Expanding access to justice and providing legal services to low-income Americans is a daunting challenge. Significant parts of the non-federal funding structure have been essentially flat or declining over the last three years. An important source of non-federal funding for LSC programs, Interest on Lawyers' Trust Accounts, declined from 12.7 percent of total funding in 2008 to 7.1 percent of total funding in 2010. State and local grants and United Way contributions also have declined.

LSC grants and related support in 2010 represented 43.6 percent of the total revenue that LSC grantees received. LSC appropriations increased from 2007 to 2010, then declined by 3.8 percent in 2011. On November 17, 2011, Congress voted to reduce LSC funding to $348 million in Fiscal Year 2012. The appropriation reduced basic field funds by 14.8 percent, compared to Fiscal Year 2011, and is likely to lead to staff layoffs and reduced services at LSC-funded programs. Going forward, LSC and grantees will face very significant challenges in meeting the growing demand for civil legal assistance at a time of federal budget reductions.

The Corporation also faces a funding-related challenge in the near future. Current appropriation law requires that LSC funding for basic field grants be distributed to each LSC-identified service area based on the area's pro-rata share of the number of individuals in poverty as determined by the most recent decennial census. The 2010 decennial census, however, did not collect information on the number of Americans in poverty in the 50 states and the District of Columbia. Consequently, statutory changes in the LSC appropriation are needed starting in Fiscal Year 2013. LSC is consulting with the Congress and the Office of Management and

Budget on the necessary changes. Shifts in the location of the U.S. poverty population since the 2000 census could result in some LSC service areas losing up to 30 percent of their share of LSC funding.

The Board and LSC are currently developing a new Strategic Directions document for the years 2011-2015. LSC solicited comments for the development of the Strategic Directions on December 23, 2010 in a notice published in the Federal Register and has recently conducted surveys of grantees and LSC staff about LSC's strategic direction. Work on the new Strategic Directions should be finished in early 2012.

In Fiscal Year 2012, LSC management expects Board action on the recommendations of the Special Task Force on Fiscal Oversight.

LSC is implementing recommendations from a June 2010 report by the Government Accountability Office (GAO) regarding controls over grant awards and grantee program effectiveness. LSC believes that 13 of the 17 recommendations in the report have been implemented and is awaiting GAO's confirmation. Pending recommendations are linked to the completion of LSC's new Strategic Directions.

An additional challenge facing LSC involves expanding access to justice by increasing pro bono and volunteer services at legal aid programs. The LSC Board has created a Pro Bono Task Force, which held its first meeting on August 1, 2011 at the Harvard Law School. The Task Force has established working groups that have been asked to develop innovative recommendations focused on increasing volunteer and pro bono services to low-income Americans. The working groups are examining best practices for urban and rural areas, best practices in the use of technology, and the obstacles that hinder lawyers who volunteer or want to volunteer at legal aid programs. The Task Force expects to report preliminary recommendations in the spring of 2012.

LSC also has started the process to negotiate its first collective bargaining agreement with its unionized employees. Employees in professional and administrative positions are represented by the International Federation of Technical and Professional Engineers.

Recent Events

In preparing these financial statements, LSC has evaluated events and transactions for potential recognition or disclosure through January 9, 2012, the date the financial statements were issued.

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

In planning and performing our audit of the financial statements of Legal Services Corporation ("LSC") for the year ended September 30, 2011, in accordance with auditing standards generally accepted in the United States of America, we considered the LSC's internal control over financial reporting (internal control) 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 the organization's internal control. Accordingly, we do not express an opinion on the effectiveness of the LSC's internal control.

However, during our audit we became aware of a matter that is an opportunity for strengthening internal controls and operating efficiency. We previously reported on LSC's internal control in our letter dated January 9, 2012. This letter does not affect our report dated January 9, 2012, on the financial statements of Legal Services Corporation.

We will review the status of this comment during our next audit engagement. We have already discussed this comment and suggestions with various LSC personnel, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations. Our comments are summarized as follows:

<u>Audit Timeline</u>

The LSC Office of Inspector General contracted with WithumSmith+Brown (WS+B) to perform LSC's financial statement audit and issue a draft audit report by December 5, 2011. This date was selected in concurrence with management. However, shortly after the audit entrance conference, management indicated it would not be able to deliver some of the information by the requested dates. During the conduct of the audit, LSC management then encountered additional challenges which caused timelines to further drift. Therefore, the final audit report could not be issued on time. As a result, the completion of a timely annual audit requires a greater coordination between LSC management, the Board, and the OIG to ensure that audit timelines are realistic and achievable, and that agreed-upon timeframes are met.

<u>Management Response</u>

LSC Management worked diligently and cooperatively to provide information on a timely basis for your audit of its financial statements for the year ended September 30, 2011. Nevertheless, Management agrees that the completion of a timely annual audit requires greater coordination among the LSC Management, the Office of Inspector General, and the audit firm to ensure than audit timelines are realistic and achievable, and that agreed-upon timelines are met.

We wish to thank the Comptroller and Inspector General and their departments for their support and assistance during our audit.

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

Withum Smith+Brown, PC

Silver Spring, MD
January 9, 2012