





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 2012 Financial Statement Audit Report

DATE: January 3, 2013

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, 2012. 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 Auditors' Report on LSC's Financial Statements and Report On Internal Control over Financial Reporting and On Compliance and Other Matters by WS+B were dated December 26, 2012. The OIG received the final reports from the Independent Auditor on January 2, 2013.

The Independent Auditors' 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, 2012, 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.

WS+B's Report On Internal Control over Financial Reporting and On Compliance and Other Matters identified no material weaknesses in internal control and no reportable noncompliance with laws and regulations.

OIG reviewed the audit 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 audit reports, dated December 26, 2012, along with the conclusions expressed in the reports.

As part of the audit report, the OIG is transmitting a management letter prepared by the Independent Auditor that addresses a weakness in the controls surrounding the bank reconciliation process and with the voiding of checks. The management letter included five recommendations to address this weakness which LSC management agreed to implement.

Attachment

cc: Jim Sandman
President



**WithumSmith+Brown
A Professional Corporation
Certified Public Accountants and Consultants**

Legal Services Corporation

Financial Statements

September 30, 2012 and 2011

With Independent Auditors' Report

Legal Services Corporation
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September 30, 2012 and 2011

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Independent Auditors' Report

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

We have audited the accompanying statements of financial position of Legal Services Corporation ("LSC") as of September 30, 2012 and 2011, and the related statements of activities and change in net assets, and cash flows for the years 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 audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits 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, 2012 and 2011, and the changes in its net assets and its cash flows for the years 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 December 26, 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.

WithumSmith+Brown, PC

Silver Spring, Maryland
December 26, 2012

Basic Financial Statements

Legal Services Corporation
Statements of Financial Position
September 30, 2012 and 2011

	2012	2011
Assets		
Current Assets		
Cash and cash equivalents	\$ 73,577,157	\$ 80,128,158
Accounts receivable, net	29,073	16,473
Prepaid expenses and deposits	228,840	174,875
Total current assets	<u>73,835,070</u>	<u>80,319,506</u>
Property and equipment, net	<u>637,802</u>	<u>754,240</u>
	<u>\$ 74,472,872</u>	<u>\$ 81,073,746</u>
Liabilities and Net Assets		
Current Liabilities		
Grants and contracts payable	\$ 60,201,520	\$ 64,187,855
Accounts payable	600,877	968,328
Accrued vacation and other liabilities	1,098,335	1,225,290
Deferred revenue	3,630,389	6,674,663
Total current liabilities	<u>65,531,121</u>	<u>73,056,136</u>
Net assets		
Unrestricted		
Undesignated	7,326,689	6,395,222
Board designated	690,069	855,648
Net investment in fixed assets	637,802	754,240
Total unrestricted	<u>8,654,560</u>	<u>8,005,110</u>
Temporarily restricted	<u>287,191</u>	<u>12,500</u>
Total net assets	<u>8,941,751</u>	<u>8,017,610</u>
	<u>\$ 74,472,872</u>	<u>\$ 81,073,746</u>

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, 2012

	Unrestricted	Temporarily Restricted	Total
Support and Revenues			
Federal appropriations	\$ 348,000,000	\$ -	\$ 348,000,000
Grant revenue	2,726,363	293,000	3,019,363
Other income	11,569	-	11,569
Change in deferred revenue	3,044,274	-	3,044,274
Net assets released from restriction	18,309	(18,309)	-
Total Revenue	353,800,515	274,691	354,075,206
Expenses			
Program services			
Grants and contracts	332,178,276	-	332,178,276
Herbert S. Garten Loan Repayment Assistance Program	575,462	-	575,462
Supporting services			
Management and grants oversight	16,025,687	-	16,025,687
Office of Inspector General	4,371,640	-	4,371,640
Total Expenses	353,151,065	-	353,151,065
Change in net assets	649,450	274,691	924,141
Net assets, beginning of year	8,005,110	12,500	8,017,610
Net assets, end of year	\$ 8,654,560	\$ 287,191	\$ 8,941,751

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. Garden 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
Statements of Cash Flows
Years Ended September 30, 2012 and 2011

	2012	2011
Cash flows from operating activities		
Change in net assets	\$ 924,141	\$ 388,958
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Depreciation and amortization	315,820	225,917
Loss on disposal of assets	-	268
Changes in assets and liabilities:		
Accounts receivable	(12,600)	303
Prepaid expenses and deposits	(53,965)	205,669
Grants and contracts payable	(3,986,334)	(5,243,455)
Accounts payable	(367,451)	610,019
Accrued vacation and other liabilities	(126,955)	213,641
Deferred revenue	(3,044,274)	718,856
Net cash used by operations	<u>(6,351,618)</u>	<u>(2,879,824)</u>
Cash flows from investing activities		
Purchase of property and equipment	<u>(199,383)</u>	<u>(588,429)</u>
Net cash used by investing activities	<u>(199,383)</u>	<u>(588,429)</u>
Net decrease in cash and cash equivalents	(6,551,001)	(3,468,253)
Cash and cash equivalents		
Beginning of year	<u>80,128,158</u>	<u>83,596,411</u>
End of year	<u>\$ 73,577,157</u>	<u>\$ 80,128,158</u>
Supplemental information		
Income taxes paid	\$ -0-	\$ -0-
Interest paid	\$ -0-	\$ -0-

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

Legal Services Corporation
Notes to the Financial Statements
September 30, 2012 and 2011

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 \$39,548,455 and \$44,411,646 as of September 30, 2012 and 2011, respectively.

Accounts Receivable

Accounts receivable are net of an allowance of \$593,848 and \$1,113,777 as of September 30, 2012 and 2011, respectively, 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.

Legal Services Corporation
Notes to the Financial Statements
September 30, 2012 and 2011

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 statements 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 \$690,069 and \$855,648 of the fund balance for continuing programs and administrative activities as of September 30, 2012 and 2011, respectively. 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, 2012 and 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, 2012 and 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, 2009, 2010 and 2011 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. Should there be a significant reduction in this revenue, LSC's programs and activities could be negatively affected.

3. Concentration of Credit Risk – Deposits

At September 30, 2012 and 2011, LSC funds are in non-interest bearing accounts. LSC's cash accounts are subject to Federal Deposit Insurance Corporation (FDIC) limits. Non-interest bearing accounts are fully insured by the FDIC through December 31, 2012. As of January 1, 2013, FDIC insurance coverage will be limited to \$250,000 per institution. Management is currently evaluating options for maintaining acceptable levels of risk.

Legal Services Corporation
Notes to the Financial Statements
September 30, 2012 and 2011

4. Equipment

Property and equipment consists of the following at September 30, 2012:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Disposals</u>	<u>Ending Balance</u>
Furniture and equipment	\$ 2,309,951	\$ 100,216	\$ (76,340)	\$ 2,333,827
Software	467,022	99,166	-	566,188
Leasehold improvements	455,647	-	-	455,647
Subtotal	<u>3,232,620</u>	<u>199,382</u>	<u>(76,340)</u>	<u>3,355,662</u>
Less: Accumulated depreciation /amortization	<u>(2,478,380)</u>	<u>(315,820)</u>	<u>76,340</u>	<u>(2,717,860)</u>
Capital assets (net)	<u>\$ 754,240</u>	<u>\$ (116,438)</u>	<u>\$ -</u>	<u>\$ 637,802</u>

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

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Disposals</u>	<u>Ending Balance</u>
Furniture and equipment	\$ 1,939,453	\$ 423,506	\$ (53,008)	\$ 2,309,951
Software	406,050	60,973	-	467,023
Leasehold improvements	351,698	103,949	-	455,647
Subtotal	<u>2,697,201</u>	<u>588,428</u>	<u>(53,008)</u>	<u>3,232,621</u>
Less: Accumulated depreciation /amortization	<u>(2,305,205)</u>	<u>(225,917)</u>	<u>52,741</u>	<u>(2,478,381)</u>
Capital assets (net)	<u>\$ 391,996</u>	<u>\$ 362,511</u>	<u>\$ (267)</u>	<u>\$ 754,240</u>

Depreciation/amortization expense for the years ended September 30, 2012 and 2011 was \$315,820 and \$225,917, respectively.

5. 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 year ended September 30, 2012 and 2011, total \$2,726,363 and \$2,315,360, respectively.

The Public Welfare Foundation (PWF) has awarded LSC two grants totaling \$293,000: a planning grant (grant # 12-014) and a resulting research grant (grant # 12-131). An overview of both grants appears below.

Planning Grant (grant # 12-014): On November 18, 2011, PWF informed LSC of the award of a planning grant in the amount of \$17,000. The grant period initially was scheduled to run for two months, from December 1, 2011 through January 31, 2012. The grant was designated to conduct preliminary planning in preparation for the design and implementation of a new outcomes measurement and reporting system for LSC and its grantees. PWF made full payment of the planning grant funds to LSC on January 17, 2012. LSC currently has \$11,191 in unexpended funds from the planning grant, and PWF granted a no-cost extension to LSC until December 31, 2012.

Research Grant (grant # 12-131): On June 18, 2012, PWF informed LSC of the award of a grant in the amount of \$276,000. The grant period is scheduled to run for eighteen months, from July 1, 2012 through

Legal Services Corporation
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December 31, 2013. The grant is designated to support work by LSC in furtherance of two goals: (1) to improve LSC's data collection system to strengthen its assessment efforts and secure information to advance its goal of equal access to justice for the poor; and (2) to provide data analysis tools to help LSC's grantees manage their operations and increase financial support for their work. PWF made full payment of the grant funds to LSC on July 16, 2012.

6. Grants and Contracts Expense

Grants and contracts expense for the years ended September 30, 2012 and 2011 consists of the following:

	<u>2012</u>	<u>2011</u>
Basic Field Programs	\$ 323,232,739	\$ 377,892,573
U.S. Court of Veterans Appeals	2,721,170	2,311,575
Grant From Other Funds	253,346	111,409
Technology Initiatives	6,045,050	2,903,326
Grant Recoveries	<u>(74,029)</u>	<u>(191,669)</u>
Total	<u>\$ 332,178,276</u>	<u>\$ 383,027,214</u>

7. Management and Grants Oversight

Management and grants oversight expenses for the years ended September 30, 2012 and 2011 consists of the following:

	<u>2012</u>	<u>2011</u>
Compensation and benefits	\$ 11,461,883	\$ 12,157,984
Temporary employee pay	434,164	507,879
Consulting	540,767	618,469
Travel and transportation	717,372	800,518
Communications	86,509	106,815
Occupancy cost	1,711,870	1,730,590
Printing and reproduction	61,182	62,706
Other operating expenses	696,122	696,319
Capital expenditures	<u>63,459</u>	<u>515,182</u>
Total	15,773,328	17,196,462
Depreciation and amortization	315,819	225,917
Loss on disposal of assets	-	268
Less: capitalized assets	<u>(63,460)</u>	<u>(515,448)</u>
	<u>\$ 16,025,687</u>	<u>\$ 16,907,199</u>

Legal Services Corporation
Notes to the Financial Statements
September 30, 2012 and 2011

8. Office of Inspector General

LSC's Office of Inspector General expenses for the years ended September 30, 2012 and 2011 were as follows:

	<u>2012</u>	<u>2011</u>
Compensation and benefits	\$ 3,743,718	\$ 3,579,686
Temporary employee pay	22,647	8,408
Consulting	312,569	167,188
Travel and transportation	206,430	199,678
Communications	17,792	17,331
Occupancy cost	-	1,482
Printing and reproduction	8,170	8,271
Other operating expenses	60,313	56,668
Capital expenditures	<u>135,922</u>	<u>73,246</u>
 Total	 4,507,561	 4,111,958
 Less: capitalized assets	 (135,921)	 (73,246)
	<u>\$ 4,371,640</u>	<u>\$ 4,038,712</u>

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.

Legal Services Corporation
Notes to the Financial Statements
September 30, 2012 and 2011

LSC's contributions to these plans for the years ended September 30, 2012 and 2011 were \$999,611 and \$994,311, respectively. The amounts are included in compensation and benefits for management and administration expenses.

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. A new lease agreement was entered into September 2012, commencing in June 2013, for an additional 10 years. 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 leases as of September 30, 2012 are as follows:

<u>Fiscal Year</u>	<u>Amount</u>
2013	\$ 1,710,000
2014	1,710,000
2015	1,710,000
2016	1,710,000
2017	1,710,000
Thereafter	9,690,000
	<u>\$ 18,240,000</u>

Rental expense for the years ended September 30, 2012 and 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.

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.

Legal Services Corporation
Notes to the Financial Statements
September 30, 2012 and 2011

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, 2012 and 2011 were \$0 and \$9,448, respectively and the amount due at September 30, 2012 and 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.

	<u>2012</u>	<u>2011</u>
LRAP balances at September 30, 2012 and 2011 are as follows:		
Cash	\$ 1,606,088	\$ 1,176,638
Accounts receivable, net	\$ 4,952	\$ 7,535
Deferred revenue	\$ 1,611,040	\$ 1,184,223

LRAP activity for the years ended September 30, 2012 and 2011 are as follows:

Loans made	\$ 573,308	\$ 1,518,607
Loans forgiven	\$ 1,095,391	\$ 866,953
Allowance for loan forgiveness	\$ (519,929)	\$ 650,693

Legal Services Corporation
Notes to the Financial Statements
September 30, 2012 and 2011

13. Temporarily Restricted Net Asset

In 2012, LSC received a donation totaling \$293,000 from the Public Welfare Foundation for the development and implementation of improvements to LSC's system for data collection and analysis, develop data collection tool kit for grantees to use and provide training and technical assistance for its use. The balance of the donation at September 30, 2012 was \$287,191.

In 2011, LSC received donations totaling \$12,500 which are restricted for the American Bar Foundation *Access Across America* research project. These funds were expended in 2012.

14. Subsequent Events

Legal Services Corporation has evaluated subsequent events occurring after the statements of financial position date through the date of December 28, 2012 the date the financial statements were available for release.

Fiscal Year 2013 Funding

Congress passed a Continuing Resolution (CR) in September 2012 as a six-month stopgap spending measure for FY 2013. The CR prevents a government shutdown on October 1 and funds federal programs until March 27, 2013 (H.J Res 117), since Congress did not pass the appropriations bills for Fiscal Year 2013. The CR provides funding at the \$1.047 trillion cap set for discretionary spending in the Budget Control Act of August 2011 (P.L. 112-250). This is \$8 billion more than the current FY 2012 levels. The increased spending is divided across the board for nearly all federal agencies at .612 percent.

LSC's total funding under the CR for FY 2013 is \$350,129,760, an increase of \$2,129,760 from FY 2012, on an annualized basis. This increase would be applied evenly across LSC's budget line items; basic funding would increase by \$1,973,088 on an annualized basis.



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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, 2012 and have issued our report thereon dated December 26, 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.



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 a certain matter that we reported to management of LSC in a separate letter dated December 26, 2012.

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

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

Silver Spring, Maryland
December 26, 2012

Appendix

Legal Services Corporation Management's Discussion and Analysis September 30, 2012 and 2011

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

Congress enacted legislation establishing the Legal Services Corporation (LSC) as a private nonprofit organization 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 in the United States. LSC currently provides grants to 134 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 grant-making process, and provides oversight and 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.

LSC is currently implementing the recommendations of the Fiscal Oversight Task Force report issued in 2011 that was adopted by LSC's Board of Directors in January 2012. The report is available at <http://www.lsc.gov/media/press-releases/lsc-solicits-public-comment-report-fiscal-oversight-task-force>.

In furtherance of the Task Force's recommendations, LSC has hired a Vice President for Grants Management to oversee the Corporation's day-to-day programmatic operations, competitive grants process, and assessment and oversight of grantees, and to lead the consolidation of three of LSC's offices (OPP, OCE and the Office of Information Management) as recommended by the Task Force Report.

Other Corporation offices include the Office of Finance and Administration, Office of Legal Affairs, Office of Information Technology and the Office of Government Relations and Public Affairs.

In addition to these offices, LSC has an independent Office of Inspector General (OIG), established by statute 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; the need for and progress of corrective actions 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.

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

Legal Services Corporation Management's Discussion and Analysis September 30, 2012 and 2011

by state and local appropriations, Interest on Lawyers' Trust Accounts (IOLTA) funds, court filing-fee surcharges, foundation support, and private contributions.

LSC currently awards and oversees grants to 134 independent, nonprofit legal aid programs in every state, the District of Columbia, and U.S. territories. Persons eligible for LSC-funded services are generally at or below 125 percent of the federal poverty line; in 2012 that was an income of \$28,813 for a family of four, and \$13,963 for a single person.

Nearly 61 million Americans are eligible for LSC-funded services, according to the most recent U.S. Census Bureau count for the year 2011. That is nearly one in five Americans, and an increase of 4.1 million people from 2009.

In 2011, the year for which the most recent data are available, matters involving family law represented 34.4 percent of cases closed by LSC-funded programs. The next largest category involved housing law, at 26 percent of cases closed. Other major case categories were income maintenance (12.7 percent) and consumer issues (11.7 percent). LSC-funded programs closed a total of 899,817 cases in 2011. 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. Between 2008 and 2010, the number of cases closed through the involvement of private attorneys increased by 15.5 percent. Due to funding cuts from Congress for FY 2011, however, cases closed by private attorney involvement dropped by nearly 5,000 cases or 5 percent from the previous year. LSC-funded programs continue to reach more citizens through websites, and increasing numbers of legal forms and other information are being downloaded every year. In 2011, more than 1 million self-help forms and printed materials were downloaded.

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) comparative 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 2012 and 2011 and an overview of the fiscal year 2012 operating budget experience.

Financial Highlights

On November 17, 2011, the Congress appropriated \$348 million to LSC for Fiscal Year 2012, a reduction of approximately \$56 million from FY 2011. The funding reduction was taken from basic field grants, a cut of 14.8 percent. The FY 2012 cut was the second year in a row that LSC's funding was reduced. LSC's appropriation rose to \$420 million in FY 2010 and dropped to \$404.2 million in FY 2011; the entire reduction was in basic field grants. The last time LSC was funded at \$348 million was in 2007.

Congress passed a Continuing Resolution (CR) in September 2012 as a six-month stopgap spending measure for FY 2013. The CR funds federal programs until March 27, 2013 (H.J. Res 117). LSC's total funding under the CR for FY 2013 is \$350,129,760, an increase of \$2,129,760 from FY 2012, on an annualized basis. This increase would be applied evenly across LSC's budget line items; basic field funding would increase by \$1,973,088 on an annualized basis.

**Legal Services Corporation
Management's Discussion and Analysis
September 30, 2012 and 2011**

LSC's funding and financial status are dependent on action by Congress, and, as the experience of the last three years demonstrates, can fluctuate materially. Any funds not expended in one fiscal year are carried over into the following fiscal year.

**Legal Services Corporation
Management's Discussion and Analysis
September 30, 2012 and 2011**

The following tables show the critical elements of the budgets and their breakdowns for fiscal years 2012 and 2011:

Table 1--For the year ended September 30, 2012

	(1) FY 2012 Appropriations	(2) FY 2012 Funding Reduction & Recission	(3) FY 2011 Carryover	(4) Court of Vets Appeals & Adjustments	(5) FY 2012 Consolidated Operating Budget
I. Delivery of legal assistance					
1. Basic Field Programs	\$ 322,400,000	\$ -	\$ 1,666,604	\$ -	\$ 324,066,604
2. US Court of Veterans Appeals Funds	-	-	3,807	2,726,363	2,730,170
3. Grants From Other Funds	-	-	725,077	-	725,077
4. Technology Initiatives	3,400,000	-	3,826,487	-	7,226,487
Delivery of legal assistance total	<u>325,800,000</u>	<u>-</u>	<u>6,221,975</u>	<u>2,726,363</u>	<u>334,748,338</u>
II. Management & grant oversight	17,000,000	-	4,302,956	293,000	21,595,956
III. Herbert S. Garten loan repayment assistance program	1,000,000	-	1,181,550	-	2,181,550
IV. Inspector General	4,200,000	-	2,231,553	-	6,431,553
Total Budget	<u>\$ 348,000,000</u>	<u>\$ -</u>	<u>\$ 13,938,034</u>	<u>\$ 3,019,363</u>	<u>\$ 364,957,397</u>

**Legal Services Corporation
Management's Discussion and Analysis
September 30, 2012 and 2011**

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	<u>397,800,000</u>	<u>(15,765,600)</u>	<u>4,899,428</u>	<u>2,315,360</u>	<u>389,249,188</u>
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)	2,164,280	-	3,162,280
IV. Inspector General	4,200,000	(8,400)	2,151,911	-	6,343,511
Total Budget	<u>\$ 420,000,000</u>	<u>\$ (15,810,000)</u>	<u>\$ 13,655,545</u>	<u>\$ 2,315,360</u>	<u>\$ 420,160,905</u>

Legal Services Corporation
Management's Discussion and Analysis
September 30, 2012 and 2011

Table 2
Statement of Financial Position

	September 30	
	<u>2012</u>	<u>2011</u>
Total current assets and other assets	\$ 73,835,070	\$80,319,506
Net property and equipment	<u>637,802</u>	<u>754,240</u>
Total Assets	<u>74,472,872</u>	<u>81,073,746</u>
Grants and contracts payable	\$ 60,201,520	\$64,187,855
Other liabilities	1,699,212	2,193,618
Deferred revenue	<u>3,630,389</u>	<u>6,674,663</u>
Total Liabilities	65,531,121	73,056,136
Net Assets		
Undesignated	7,326,689	6,395,222
Designated	690,069	855,648
Net investment in fixed assets	637,802	754,240
Temporarily restricted	<u>287,191</u>	<u>12,500</u>
Total Net Assets	<u>8,941,751</u>	<u>8,017,610</u>
Total Liabilities and Net Assets	<u>\$ 74,472,872</u>	<u>\$81,073,746</u>

Legal Services Corporation
Management's Discussion and Analysis
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Table 3
Statement of Activities

	Years ended September 30,	
	2012	2011
Revenue		
Federal appropriations	\$ 348,000,000	\$ 404,190,000
Grant revenue	3,019,363	2,315,360
General revenues		
Change in deferred revenue	3,044,274	(718,856)
Contributed Services	-	67,145
Interest & other income	11,569	26,080
Total revenue	354,075,206	405,879,729
Expenses		
Program activities	332,753,738	384,544,860
Supporting activities	20,397,327	20,945,911
Total expenses	353,151,065	405,490,771
Change in net assets	924,141	388,958
Net assets, beginning of year	8,017,610	7,628,652
Net assets end of year	\$ 8,941,751	\$ 8,017,610

**Legal Services Corporation
Management's Discussion and Analysis
September 30, 2012 and 2011**

Fiscal Year 2012 and 2011 MGO Budgetary Analysis and Activity Description

Table 4 presents the final budgets for Management and Grants Oversight (MGO) for Fiscal Years 2012 and 2011.

**Table 4
Management and Grants Oversight
Operating Budgets for Years Ending September 2012 and 2011**

<u>Budget Category</u>	<u>2012</u>	<u>2011</u>
Compensation and benefits	\$ 13,319,050	\$ 14,905,225
Temporary employee pay	659,950	578,725
Consulting	1,346,100	1,127,200
Travel & transportation expenses	1,306,650	1,292,850
Communications	152,150	177,550
Occupancy cost	1,758,500	1,759,650
Printing and reproduction	91,100	101,150
Other operating expenses	2,573,756	803,576
Capital expenditures	<u>388,700</u>	<u>660,000</u>
Total	<u>\$ 21,595,956</u>	<u>\$ 21,405,926</u>

OPP focuses 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 2012, OPP:

- Conducted full program quality visits to 21 grantee programs and one capability assessment in 17 states and territories to ensure the delivery of high-quality civil legal assistance.
- Performed 14 shorter program evaluation or technical assistance visits to another 16 programs in 11 states and territories to assess grantee activities, to follow-up on prior concerns, or provide technical assistance.
- Evaluated 72 proposals for funding from 47 applicants for 71 service areas in 31 states and territories, including one multiple-applicant area.
- Awarded 35 new Technology Initiative Grants (TIG), totaling more than \$2.5 million in 23 states and one territory. TIG funded several technology projects to enhance data analysis. These projects leverage technology to make better use of data to improve the effectiveness and efficiency of services provided to clients. TIG funding is also supporting several projects that use technology to increase pro bono involvement.
- 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 202 attorneys in 100 programs received loans in FY 2012. Recipients ranged from new hires to attorneys with six years of service with a grantee.

**Legal Services Corporation
Management's Discussion and Analysis
September 30, 2012 and 2011**

- Provided guidance to LSC-funded programs in more than 16 states preparing for or responding to disasters, hosted three national disaster update and networking calls, and coordinated disaster relief funding to begin in 2012 for Legal Aid of Western Missouri to serve persons affected by the May 22, 2011 tornado in Joplin, Missouri.

During Fiscal Year 2012, 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 2012, OCE:

- Conducted 17 Case Service Report/Case Management System (CSR/CMS) reviews, five follow-up reviews, and one financial internal controls review.
- Received 30 audit finding referrals from the Office of Inspector General for the audited financial statements for fiscal years ending between 6/30/11 and 12/31/11. OCE also received and, as appropriate, acted on 40 audit findings referred from audited financial statements for fiscal years ending between 12/31/10 and 12/31/11.
- Opened 68 complaints against grantees for violations of the LSC Act, regulations and guidelines, and closed 67 complaints.
- Reviewed and approved 61 subgrants.
- Reviewed 126 grantee/subgrantee-audited financial statements for fiscal years 2010 and 2011 to ensure compliance with the LSC Accounting Guide.
- Reviewed and approved fund balances at grantees, acting on 17 fund-balance waiver requests.
- Provided on-site CSR training for one grantee and continued to offer webinar based training for new Executive Directors.

Note 7 under Notes to Financial Statements presents the final expenses for MGO for fiscal years 2012 and 2011.

Legal Services Corporation Management's Discussion and Analysis September 30, 2012 and 2011

Fiscal Year 2012 OIG Budgetary Analysis and Activity Description

(The OIG prepared this section and it is included without change.)

In fulfilling the Inspector General duties at LSC, the OIG was guided by its own multi-year strategic plan and led by Inspector General Jeffrey E. Schanz. The FY 2012 OIG budget funded reviews of external grant recipients, IPAs, and internal LSC management operations and activities.

External grant recipient and IPA focused projects included:

- Audits of selected internal controls or technology initiative grants at LSC grant recipients including Center for Arkansas Legal Services, North Mississippi Rural Legal Services, Texas RioGrande Legal Aid, Southeast Louisiana Legal Services, South Jersey Legal Services, Inland Counties Legal Services (CA), Legal Services of Southern Missouri and an additional four grantee audits in progress at the end of the fiscal year;
- Desk reviews of 134 grantee audit reports with referral of all significant findings to LSC management for follow-up and resolution;
- Quality Control Reviews (QCR) to provide greater assurance as to the quality of the IPAs' audit work and identify or respond to potential concerns that may arise with a particular grantee or IPA. The reviews are conducted by an independent certified public accounting firm, operating under contract to the OIG. This fiscal year 39 QCRs were completed with a summary advisory memorandum sent to all IPA's and grantees and another 11 QCRs were in progress;
- Investigations of fraud or financial irregularities and subsequent prosecutions of significant theft of grant recipient funds, as well as, investigations of regulatory compliance. After a thorough review, the OIG closed 26 investigations of criminal and compliance matters;
- Proactive fraud awareness briefings designed to assist LSC and its grantees in preventing and detecting fraud; as well as advisories, webinars, fraud and regulatory vulnerability assessments. The OIG closed eight fraud vulnerability assessments and six regulatory vulnerability assessments; and performed 28 fraud awareness briefings, two webinars (available to all LSC grantees) and issued two fraud and one information security advisories;
- Operation of a nation-wide Hotline for the reporting of suspected fraud, waste or abuse in recipient programs or LSC;
- Continued involvement in litigation seeking subpoena enforcement in support of an investigation of a LSC grantee's possible violations of Congressional restrictions.

Projects reviewing selected LSC management operations and activities included:

- Oversight of the FY 2011 LSC corporate audit;
- Comments on LSC's proposed amendments to its regulations on enforcement mechanisms;
- Recommended to LSC Board Committee the use of the normal rulemaking process for proposal to alter the application of LSC's subgrant regulation;
- Recommendations on LSC's draft Strategic Plan for 2012 -2016;
- Workplace Safety and Security review update.

**Legal Services Corporation
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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.

Table 5 presents the final OIG budgets for Fiscal Years 2012 and 2011.

**Table 5
Office of Inspector General
Operating Budgets for Years Ending September 2012 and 2011**

<u>Budget Category</u>	<u>2012</u>	<u>2011</u>
Compensation and benefits	\$ 3,954,400	\$ 3,883,891
Temporary employee pay	40,000	40,000
Consulting	619,850	893,000
Travel & transportation expenses	385,000	400,000
Communications	34,050	44,700
Occupancy cost	6,000	6,000
Printing and reproduction	10,100	10,000
Other operating expenses	1,182,153	965,820
Capital expenditures	200,000	100,100
Total	<u>\$ 6,431,553</u>	<u>\$ 6,343,511</u>

**Legal Services Corporation
Management's Discussion and Analysis
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**Table 6
Office of Inspector General
Operating Budget versus Actual Expenditures
For the year ended September 30, 2012**

<u>Budget Category</u>	<u>Final Budget</u>	<u>Expenditures</u>	<u>Variance</u>
Compensation and benefits	\$ 3,954,400	\$ 3,743,718	\$ 210,682
Temporary employee pay	40,000	22,647	17,353
Consulting	619,850	312,569	307,281
Travel and transportation	385,000	206,430	178,570
Communications	34,050	17,792	16,258
Occupancy cost	6,000	-	6,000
Printing and reproduction	10,100	8,170	1,930
Other operating expenses	1,182,153	60,313	1,121,840
Capital expenditures	200,000	135,922	64,078
TOTAL	\$ 6,431,553	\$ 4,507,561	\$ 1,923,992
Less: capitalized assets		(135,921)	135,921
		<u>\$ 4,371,640</u>	<u>\$ 2,059,913</u>

For the year ended September 30, 2011

<u>Budget Category</u>	<u>Final Budget</u>	<u>Expenditures</u>	<u>Variance</u>
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
		<u>\$ 4,038,712</u>	<u>\$ 2,304,799</u>

Legal Services Corporation Management's Discussion and Analysis September 30, 2012 and 2011

Future Events

In pursuit of the OIG's statutory mission, goals and objectives, the OIG will update its Strategic Plan, perform audit, evaluation, and investigative fact-finding activities and will make recommendations concerning laws and regulations affecting LSC in accordance with the IG Act and the LSC appropriations law. The OIG will continue to carry out its Congressionally-assigned responsibilities to oversee the IPAs' grantee audits, conduct reviews of grantees' internal controls, financial processes, and compliance with LSC laws and regulations, conduct audits and investigations, maintain a hotline, and evaluate the effectiveness and efficiency of LSC and its grant recipient operations.

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 has risen substantially in recent years. 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.

In many states, significant parts of the non-federal funding structure have been essentially flat or declining over the last four years. An important source of non-federal funding for LSC programs, Interest on Lawyers' Trust Accounts, declined from \$111,797,730 in 2008 to \$60,840,247 in 2011. Total state and local grants and private grants also declined between 2010 and 2011.

LSC grants and related support in 2011 represented 43.3 percent of the total revenue that LSC grantees received. LSC appropriations increased from 2007 to 2010 and 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 has led to staff layoffs and reduced services at LSC-funded programs. Going forward, LSC and its grantees will face significant challenges in meeting the demand for civil legal assistance at a time of federal budget reductions.

At its October 2012 meeting, the Board approved a new Strategic Plan for LSC for 2012-2016. The plan sets forth three main goals for the next five years: to maximize the availability, quality, and effectiveness of the civil legal services that its grantees provide to eligible low-income individuals; to become a leading voice for civil legal services for poor Americans; and to achieve the highest standards of fiscal responsibility both for itself and its grantees.

LSC continues to make progress in implementing the recommendations from the June 2010 report by the Government Accountability Office (GAO) regarding controls over grant awards and grantee program effectiveness. To date, the GAO has closed or is in the process of closing 11 of the 17 recommendations. LSC has begun implementing the remaining open recommendations that were contingent on the Board's completion of the new strategic plan.

LSC faces an additional challenge, and an opportunity, in expanding access to justice by increasing pro bono and volunteer services at legal aid programs. The LSC Board's Pro Bono Task Force released a report of findings and recommendations on October 2, 2012 at the U.S. Capitol. The Task Force, co-chaired by Dean Martha Minow of the Harvard Law School and Harry J. F. Korrell III of Davis Wright Tremaine LLP, included more than 60 distinguished leaders and experts from the judiciary, major corporations, private practice, law schools, the federal government, and the legal aid community.

**Legal Services Corporation
Management's Discussion and Analysis
September 30, 2012 and 2011**

LSC also has begun negotiating 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

The Budget Control Act of 2011 (BCA) is scheduled to go into effect January 2, 2013 unless Congress acts prior to that date to forestall automatic tax increases and spending reductions. If the BCA spending reductions are implemented, they will result in an 8.2 percent cut in LSC's appropriation as of January 2, 2013.



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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, 2012, 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 LSC'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 December 26, 2012. This letter does not affect our report dated December 26, 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 this matter, or to assist you in implementing the recommendation. Our comments are summarized as follows:

Voided Checks/Bank Reconciliations

During our review of the September 30, 2012 bank statement and reconciliation, we noted weaknesses in the controls surrounding the bank reconciliation process and with the voiding of checks. Specifically, we found the following:

- LSC cut check #6013 on September 12, 2012 for \$22,280, payable to a grantee;
- On or before September 18, 2012, the Comptroller discovered an error in the amount of the check, so it was never mailed;
- The check was not voided in the accounting system until October 2012;
- Management had difficulty producing for the audit team the actual voided check, and required several days to locate it;
- A new check was subsequently issued on October 11, 2012 (check number 6028);
- The September 30, 2012 bank reconciliation, prepared and reviewed by the Comptroller's Office on October 31, continued to include the original check¹ as outstanding as of September 30 even after it had been voided and reissued in October; and
- LSC financial staff was not aware of GAAP requirements regarding held checks (checks not mailed until a subsequent accounting period) should be added back to cash as of September 30.

¹ Incorrectly listed as number 6004, instead of 6013



Sound business practices require transactions, including voided transactions, be recorded in the accounting system on a timely basis, and reconciliation procedures be performed to ensure that transactions are recorded correctly.

LSC's bank reconciliation is a manual process and the check number was inadvertently recorded incorrectly on the reconciliation. Additionally, LSC did not have timely procedures for voiding checks in the accounting system. Once the error was discovered, the accounting manager sought assistance from a consultant on how to properly void the check in the accounting system. However, the check was not voided until October 2012. Additionally, LSC did not maintain its voided checks in a file that is readily accessible or review that file in conjunction with its bank reconciliations.

As a result of this error, cash and accounts payable were misstated on the financial statements by \$22,280. We noted that LSC had 22 voided checks in Fiscal Year 2011 totaling \$73,824 and 48 voided checks in FY 2012 totaling \$42,181 (excluding the check referenced in this letter). Although this amount is not material, this same error could have occurred for a check in any amount.

We recommend that LSC:

- Prepare detailed written guidance on the steps needed to void a check in the accounting system;
- Establish procedures to ensure that voided checks are recorded into the accounting system prior to the end of an accounting period;
- Print a check register report to be used in conjunction with the bank register process to ensure that check numbers, dates, payees, and amounts are correct on the bank reconciliation;
- Establish procedures to capture the date checks were mailed (such as a check log), especially at year end, to ensure that held checks (checks written but not yet mailed), can be properly accounted for; and
- Explore the feasibility of using Sunsystems bank reconciliation module, or another third party bank reconciliation module that will work with Sunsystems, to streamline the bank reconciliation process and reduce the chance of error.

Management Response

During WS+B audit team's field work, the auditors identified a check that was initially prepared in September 2012 and voided in October, with a replacement check issued later in October. The initial check was never approved for release and never left the offices of LSC. LSC's Treasurer/Comptroller realized that the amount of the initial check was in error when he first reviewed it, and the check was held in the LSC safe.

LSC will clarify the voided checks procedures, and conduct and document training for our staff on it. LSC will implement all of WS+B's other recommendations.

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.

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

Silver Spring, Maryland
December 26, 2012