Office of Inspector General
Legal Services Corporation

Inspector General
Jeffrey E. Schanz

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

MEMORANDUM

TO: Board of Directors
Legal Services Corporation

FROM: Jeffrey E. Schanz
Inspector General

SUBJECT: Transmittal of FY 2019 Financial Statement Audit Report

DATE: May 21, 2020

The Office of Inspector General (OIG) contracted with the independent certified public accounting firm of CliftonLarsonAllen, LLP (CLA) to audit the financial statements of the Legal Services Corporation (LSC) as of and for the fiscal year ended September 30, 2019. The contract required that the audit be performed 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.

CLA's Independent Auditor's Report on the Financial Statements, Independent Auditor's Report on Internal Control, and Independent Auditor's Report on Compliance and Other Matters were dated April 21, 2020. The OIG received the final reports from the Independent Auditor on May 11, 2020.

In its Independent Auditor's Report on the Financial Statements, CLA reported that LSC's financial statements fairly presented, in all material respects, the financial position of LSC as of September 30, 2019, and the related statement of activities and changes in net assets, cash flows, and functional expenses for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

CLA’s Independent Auditor’s Report on the Financial Statements and Independent Auditor’s Report on Compliance with Laws and Other Matters reported that the results of their tests disclosed no instances of noncompliance or other matters required to be reported under *Government Auditing Standards*.

CLA’s Independent Auditor’s Report on Internal Control identified one significant deficiency in internal control that is considered to be less severe than a material weakness yet important enough to merit attention by those charged with governance. CLA found improper classification of board designated net assets which resulted in inaccurate presentation of net assets between the “without donor restrictions” and “with donor restrictions” categories.

The OIG reviewed the audit reports from CLA and related audit documentation and inquired of their representatives. The OIG's review disclosed no instances in which CLA did not comply, in all material respects, with *Government Auditing Standards*. Our review, as differentiated from an audit of the financial statements in accordance with U.S. 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. CLA is responsible for the attached audit reports, dated April 21, 2020, and the conclusions expressed therein.

Attachment

cc: Ron Flagg
President

LEGAL SERVICES CORPORATION

FINANCIAL STATEMENTS

YEARS ENDED SEPTEMBER 30, 2019 AND 2018

LEGAL SERVICES CORPORATION
TABLE OF CONTENTS
YEARS ENDED SEPTEMBER 30, 2019 AND 2018

CliftonLarsonAllen LLP
CLAconnect.com

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of Legal Services Corporation (a nonprofit organization), which comprise the statement of financial position as of September 30, 2019, and the related statements of activities and changes in net assets, functional expenses, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Legal Services Corporation as of September 30, 2019, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

2018 Financial Statements

The 2018 financial statements of Legal Services Corporation were audited by other auditors whose report dated May 6, 2019, expressed an unmodified opinion on those statements.

Change in Accounting Principle

As discussed in Note 2 to the financial statements, the entity adopted new accounting guidance contained in Accounting Standards Update (ASU) 2016-14, *Not-for-Profit Entities* (Topic 958) – *Presentation of Financial Statements of Not-for-Profit Entities*. Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our reports dated April 21, 2020, on our consideration of Legal Services Corporation's internal control over financial reporting and the results of our test of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Legal Services Corporation's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Legal Services Corporation's internal control over financial reporting and compliance.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Greenbelt, Maryland
April 21, 2020

LEGAL SERVICES CORPORATION
STATEMENTS OF FINANCIAL POSITION
SEPTEMBER 30, 2019 AND 2018

	2019	2018
ASSETS		
Cash and Cash Equivalents	$ 120,563,289	$ 111,339,231
Accounts Receivable, Net	156,507	39,585
Grant Receivable	1,164,475	1,302,401
Prepaid Expenses and Other Assets	316,098	308,768
Property and Equipment, Net	383,391	408,798
Contributions Receivable	365,000	15,000
Total Assets	$ 122,948,760	$ 113,413,783
LIABILITIES AND NET ASSETS		
LIABILITIES		
Grants Payable	$ 63,996,651	$ 63,697,162
Accounts Payable and Accrued Expenses	554,199	578,129
Accrued Payroll and Other Payroll Liabilities	1,388,196	1,271,654
Deferred Revenue	800,000	-
Total Liabilities	66,739,046	65,546,945
NET ASSETS		
Without Donor Restrictions	8,151,404	10,922,324
With Donor Restrictions	48,058,310	36,944,514
Total Net Assets	56,209,714	47,866,838
Total Liabilities and Net Assets	$ 122,948,760	$ 113,413,783

See accompanying Notes to Financial Statements.

LEGAL SERVICES CORPORATION
STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS
YEARS ENDED SEPTEMBER 30, 2019 AND 2018

	2019			2018		
	Without Donor Restrictions	With Donor Restrictions	Total	Without Donor Restrictions	With Donor Restrictions	Total
SUPPORT AND REVENUE						
Federal Appropriations	$ 24,725,000	$ 405,275,000	$ 430,000,000	$ 24,725,000	$ 400,275,000	$ 425,000,000
Grant Revenue	-	2,580,000	2,580,000	-	2,580,000	2,580,000
Contributions	292,927	1,095,835	1,388,762	365,234	176,500	541,734
Investment Income	103,113	1,681,340	1,784,453	-	-	-
Other Income	388,504	-	388,504	142,203	-	142,203
Donated Services	-	-	-	250,000	-	250,000
Net Assets Released from Restriction	399,518,379	(399,518,379)	-	380,070,896	(380,070,896)	-
Total Support and Revenue	425,027,923	11,113,796	436,141,719	405,553,333	22,960,604	428,513,937
EXPENSES						
Program Services:						
Grants and Contracts	412,111,006	-	412,111,006	390,424,867	-	390,424,867
Herbert S. Garten Loan Repayment Assistance Program	1,097,425	-	1,097,425	1,052,520	-	1,052,520
Total Program Services	413,208,431	-	413,208,431	391,477,387	-	391,477,387
Supporting Services:						
Management and Grant Oversight	8,811,344	-	8,811,344	7,889,437	-	7,889,437
Office of Inspector General	5,439,598	-	5,439,598	4,995,188	-	4,995,188
Fundraising (Institutional Advancement)	339,470	-	339,470	269,416	-	269,416
Total Supporting Services	14,590,412	-	14,590,412	13,154,041	-	13,154,041
Total Expenses	427,798,843	-	427,798,843	404,631,428	-	404,631,428
CHANGE IN NET ASSETS	(2,770,920)	11,113,796	8,342,876	921,905	22,960,604	23,882,509
Net Assets - Beginning of Year	10,922,324	36,944,514	47,866,838	10,000,419	13,983,910	23,984,329
NET ASSETS - END OF YEAR	$ 8,151,404	$ 48,058,310	$ 56,209,714	$ 10,922,324	$ 36,944,514	$ 47,866,838

See accompanying Notes to Financial Statements.

LEGAL SERVICES CORPORATION
STATEMENT OF FUNCTIONAL EXPENSES
YEAR ENDED SEPTEMBER 30, 2019 (WITH COMPARATIVE 2018 TOTALS)

	Program Services			Supporting Services					
	Grants and Contracts	Herbert S. Garten Loan Repayment Assistance Program	Total Program Services	Management and Grant Oversight	Office of Inspector General	Fundraising (Institutional Advancement)	Total Supporting Services	Total 2019	Total 2018
Compensation and Benefits	$ 9,782,312	$ 43,464	$ 9,825,776	$ 5,945,661	$ 4,245,814	$ 285,791	$ 10,477,266	$ 20,303,042	$ 19,113,083
Temporary Personnel	433,669	2,719	436,388	470,277	-	13,443	483,720	920,108	419,720
Consulting	805,088	158	805,246	438,866	515,392	-	954,258	1,759,504	1,304,604
Travel	727,174	2,941	730,115	555,969	185,591	6,255	747,815	1,477,930	1,075,291
Communications	31,369	92	31,461	96,926	20,886	790	118,602	150,063	111,573
Occupancy	872,702	3,930	876,632	565,405	354,963	28,524	948,892	1,825,524	1,807,114
Printing and Reproduction	2,448	-	2,448	78,696	8,911	-	87,607	90,055	82,133
Other Expenses	86,702	1,043,819	1,130,521	616,167	80,808	2,479	699,454	1,829,975	1,944,002
Grants	399,302,589	-	399,302,589	-	-	-	-	399,302,589	378,655,514
Expenses Before Depreciation and Amortization	412,044,053	1,097,123	413,141,176	8,767,967	5,412,365	337,282	14,517,614	427,658,790	404,513,034
Depreciation and Amortization	66,953	302	67,255	43,377	27,233	2,188	72,798	140,053	118,394
Total Expenses	$ 412,111,006	$ 1,097,425	$ 413,208,431	$ 8,811,344	$ 5,439,598	$ 339,470	$ 14,590,412	$ 427,798,843	$ 404,631,428

See accompanying Notes to Financial Statements.

LEGAL SERVICES CORPORATION
STATEMENTS OF CASH FLOWS
YEARS ENDED SEPTEMBER 30, 2019 AND 2018

	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in Net Assets	$ 8,342,876	$ 23,882,509
Adjustments to Reconcile Change in Net Assets to Net Cash Provided by Operating Activities:		
Depreciation and Amortization	140,053	118,394
Loss on Disposal of Assets	3,623	502
Changes in Operating Assets and Liabilities:		
Accounts Receivable	(116,922)	(53,633)
Grant Receivable	137,926	(107,160)
Prepaid Expenses and Other Assets	(7,330)	33,250
Contributions Receivable	(350,000)	796,936
Grants Payable	299,489	(3,017,274)
Accounts Payable and Accrued Expenses	(23,930)	(24,918)
Accrued Payroll and Other Payroll Liabilities	116,542	203,308
Deferred Revenue	800,000	-
Net Cash Provided by Operating Activities	9,342,327	21,831,914
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of Property and Equipment	(118,269)	(314,051)
Net Cash Used by Investing Activities	(118,269)	(314,051)
NET INCREASE IN CASH AND CASH EQUIVALENTS	9,224,058	21,517,863
Cash and Cash Equivalents - Beginning of Year	111,339,231	89,821,368
CASH AND CASH EQUIVALENTS - END OF YEAR	$ 120,563,289	$ 111,339,231

See accompanying Notes to Financial Statements.

NOTE 1 ORGANIZATION AND PURPOSE

Legal Services Corporation (LSC, we, us, our) is a District of Columbia not-for-profit 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.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Financial Presentation

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 (U.S. GAAP). LSC recognizes contributions, including unconditional promises to give, as revenue in the period received. Contributions, net assets, and changes therein are classified and reported based on the existence or absence of donor-imposed restrictions. For the years ended September 30, 2019 and 2018, a portion of LSC's net assets are classified as with donor restrictions. These amounts represent contributions that are limited in accordance with donor-imposed stipulations.

(b) Cash and Cash Equivalents

LSC considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. LSC maintains its cash and cash equivalents (and certificates of deposit) in financial institutions which, at times, may exceed federally insured limits or are uninsured. LSC has not experienced any losses in such accounts.

(c) Liquidity

Financial assets available for general expenditure, that is, without donor or other restrictions limiting their use and excluding amounts obligated for basic field grants, within one year of the statement of financial position date, comprise the following as of September 30:

	2019
Cash and Cash Equivalents	$ 120,563,289
Accounts Receivable, Net	156,507
Grant and Contributions Receivable, Net	1,164,475
Total Financial Assets Available	121,884,271
Less:	
With Donor Restrictions	(48,058,310)
Basic Field Grants	(63,996,651)
Financial Assets Available to Meet Cash Needs for General Expenditures Within One Year	$ 9,829,310

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(c) Liquidity (Continued)

LSC has a goal to maintain financial assets, which consist of cash and short-term investments, on hand to meet 60 days of normal operating expenses, which are, on average, approximately $4,500,000.

(d) Program-Related Receivables

LSC makes loans to individuals to receive assistance towards the payment of their eligible law school loans through a program called the Herbert S. Garten Loan Repayment Assistance Program, which mitigates the economic hardships confronting grantee attorneys, and increases their ability and willingness to stay with legal aid organizations. Loans are measured at fair value at inception. The loans from LSC to the recipients are forgiven (written off) on an annual basis if the recipient remains employed by the legal aid organization for that year. The allowance or discount is reflective of the anticipated amount of loans that will be forgiven. The net receivable is the amount of loans that are required to be repaid by recipients for non-compliance with the program, i.e., terminating employment at a participating legal aid organization. The loss reserve estimate is reviewed on an annual basis and adjusted if collectability risk has significantly changed due to their employment status changing within an LSC funded program. At September 30, 2019 and 2018, net program related receivables, which are included in accounts receivable in the statements of financial position, were $14,700 and $4,475, respectively. The program receivables at September 30, 2019 and 2018, of $601,900 and $502,875, respectively, are offset by the allowance for loss reserve of $587,200 and $498,400, respectively.

(e) Grants and Contributions Receivable

Receivables are carried at original invoice or promise to give amount. Management determines the allowance for doubtful accounts by identifying questionable accounts and by using historical experience applied to an aging of accounts. Receivables are written off when deemed uncollectible. All grants and contributions receivable were deemed fully collectible within one year at September 30, 2019 and 2018.

(f) Property and Equipment

Property and equipment are stated at cost and depreciated using the straight-line method over the estimated useful lives of the assets. LSC annually reviews property and equipment assets for impairment of value and any adjustment necessary to reflect material impacts in value. The estimated useful lives are as follows:

Furniture and Equipment	10 years
Software	10 years
Leasehold Improvements	5 years

(g) Grants Payable

Grant expense is recognized in the period the grant is countersigned and is payable within one year, provided the grant is not subject to significant future conditions. Conditional grants are recognized as grant expense and as a grant payable in the period in which the grantee meets the terms of the conditions.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(h) Net Assets

Net assets, revenues, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets and changes therein are classified and reported as follows:

Net Assets Without Donor Restrictions – Net assets without donor restrictions include resources available for general operations of LSC, invested primarily in its property and equipment, or designated by the board of directors for a specific use and are not subject to donor-imposed restrictions.

Net Assets With Donor Restrictions – Net assets with donor restrictions consist of assets whose use is limited by donor-imposed restrictions. Donor-imposed restrictions are released when a restriction expires, that is, when the stipulated time has elapsed, when the stipulated purpose for which the resource was restricted has been fulfilled, or both.

(i) Revenue and Revenue Recognition

LSC receives federal appropriations for Management and Grants Oversight and the Office of Inspector General which are reported as revenue in the period the appropriation is enacted into law. Grants awarded to LSC are considered without donor restriction unless specifically restricted by the donor.

(j) Donated Services and In-Kind Contributions

LSC receives contributed services in support of its programs. Certain contributed services meet the criteria for recognition under U.S. GAAP. Contributed services are recognized at fair value if the services received either create or enhance long-lived assets, require specialized skills and are provided by individuals possessing those skills, and would typically need to be purchased if not provided by the donation. For the years ended September 30, 2019 and 2018, contributed services totaled $0 and $250,000, respectively, and are included in donated services revenue and program expenses in the statements of activities and changes in net assets.

(k) Functional Allocation of Expenses

The costs of providing the various programs and activities have been summarized on a program basis in the statement of activities and changes in net assets. The statement of functional expenses presents the natural classification detail of expenses by function. The majority of expenses are directly identified with a program activity or supporting service. However, certain costs are attributable to more than one program activity or supporting service and require allocation on a reasonable basis that is consistently applied. The expenses that are allocated include occupancy, depreciation, and amortization, which are allocated on a head count by program basis, as well as compensation and benefits, temporary personnel, consulting, travel, communications, printing and other office expenses, which are allocated on the basis of department designation and time worked.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(l) <u>Concentration of Risk</u>

LSC receives substantially all 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.

(m) <u>Tax Exempt Status</u>

LSC is exempt from federal income tax under the provisions of Section 501(c)(3) of the Internal Revenue Code and the applicable income tax regulations of the District of Columbia. Income, which is not related to its exempt purpose, less applicable deductions, is subject to federal and state corporate income taxes. LSC had no unrelated business income for the years ended September 30, 2019 and 2018.

(n) <u>Estimates</u>

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect reported amounts and disclosures. Accordingly, actual results may differ from those estimates and those differences could be material.

(o) <u>Change in Accounting Principle</u>

On August 18, 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-14, *Not-for-Profit Entities (Topic 958) – Presentation of Financial Statements of Not-for-Profit Entities*. The update addresses the complexity and understandability of net asset classification, deficiencies in information about liquidity and availability of resources, and the lack of consistency in the type of information provided about expenses and investment return. LSC has implemented ASU 2016-14 and has adjusted the presentation in these financial statements accordingly. Except for the statement of functional expenses and liquidity disclosure, the ASU has been applied retrospectively to all periods presented, which resulted in no change to the previously reported net assets.

(p) <u>Recent Accounting Guidance</u>

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)* along with various updates in 2016 and 2015, requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard replaced most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either a full retrospective or retrospective with cumulative effect transition method. The updated standard is effective for annual reporting periods beginning after December 15, 2018. LSC is in the process of assessing the impact of this standard on the financial statements beginning in fiscal year 2020.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(p) Recent Accounting Guidance (Continued)

In February 2016, The FASB issued ASU 2016-02, *Leases (Topic 842).* Under the new guidance, lessees are required to recognize lease assets and lease liabilities on the statement of financial position for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the statement of activities. The new standard is effective for fiscal years beginning after December 15, 2020. A modified retrospective transition approach is required for leases for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. LSC is in the process of assessing the impact of this standard on the financial statements beginning in fiscal year 2022.

In June 2018, the FASB issued ASU 2018-08, *Not-for-Profit Entities (Topic 958), Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The new standard applies to all entities that receive or make contributions. The guidance clarifies the definition of transactions accounted for as an exchange transaction subject to ASU 2014-09, and transactions that should be accounted for as contributions (non-exchange) subject to other guidance. Further, the guidance provides criteria for evaluating whether contributions are conditional or unconditional. Conditional contributions must specify a barrier that the recipient must overcome and releases the donor from its obligation if the barrier is not achieved; otherwise, the contribution is unconditional. The standard is effective for fiscal years beginning after December 15, 2018, for private companies, with early adoption permitted. LSC is in the process of assessing the impact of this standard on the financial statements beginning in fiscal year 2020.

(q) Reclassification

For comparative presentation purposes, certain 2018 amounts have been reclassified to conform to the 2019 presentation. These reclassifications had no effect on previously reported net asset amounts.

NOTE 3 PROPERTY AND EQUIPMENT

Property and equipment consist of the following at September 30:

	2019	2018
Furniture and Equipment	$ 1,750,464	$ 1,765,980
Software	33,399	33,035
Leasehold Improvements	13,095	13,095
Sub-Total	1,796,958	1,812,110
Less: Accumulated Depreciation and Amortization	(1,413,567)	(1,403,312)
Total Property and Equipment, Net	$ 383,391	$ 408,798

Depreciation and amortization expense totaled $140,053 and $118,394 for the years ended September 30, 2019 and 2018, respectively.

NOTE 4 GRANTS RECEIVABLE

LSC operates under various federal appropriations and grants from private sources. Grants and contributions receivable consist of the following at September 30:

	2019	2018
Advances to Grantees for Program Specific Grants	$ 614,475	$ 974,261
Other Private Grants	550,000	328,140
Total	$ 1,164,475	$ 1,302,401

As of September 30, 2019 and 2018, all grants receivable are expected to be collected or settled within one year.

NOTE 5 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 Systems (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).

We make CSRS 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 and the excess of total pension expense over the amount contributed by us and by our employees represents the amount that must be financed directly by OPM. Post-retirement CSRS benefits are paid by OPM. No amounts have been recognized in the financial statements for these imputed costs.

NOTE 5 RETIREMENT PLANS (CONTINUED)

We do not report in our financial statements CSRS' assets, accumulated plan benefits or unfunded liabilities, if any, applicable to the LSC's employees.

All officers and employees hired after September 30, 1988, are ineligible for the CSRS plan, but they 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. LSC contributes 6 percent of each eligible employee's salary regardless of their participation. In addition, there is a matching contribution of the first 2.51 percent contributed by the employee. Individuals can make contributions up to a maximum amount permitted under federal income tax rules.

Our contributions to these plans for the years ended September 30, 2019 and 2018, were approximately $1,314,685 and $1,202,007, respectively. The amounts are included in compensation and benefits on the accompanying statements of functional expenses.

We also offer tax deferred annuity savings plans. CSRS eligible employees may contribute pretax earnings to the federal Thrift Savings Plan, and 403(b) eligible employees may contribute additional pretax earnings to the Section 403(b) plan. These plans are subject to different maximum amounts as permitted by the prevailing laws. LSC makes no contributions to these tax deferred savings plans.

NOTE 6 NET ASSETS WITH DONOR RESTRICTIONS

Net assets with donor restrictions at September 30, 2019 and 2018, consist of:

	2019	2018
Emergency Disaster Relief	$ 22,987,340	$ 14,983,313
Technology Initiative Grant	8,930,340	10,179,997
Pro Bono Innovation	8,073,940	7,543,427
Loan Repayment Assistance	1,920,014	1,457,642
Basic Field Grants	3,764,823	568,259
U.S. Court of Veterans Appeals	71,718	70,343
Other purpose restrictions	2,310,135	2,141,533
Total	$ 48,058,310	$ 36,944,514

NOTE 7 COMMITMENTS AND CONTINGENCIES

Leases

LSC is obligated under a lease agreement for office space through May 2023. Total rent expense for the years ended September 30, 2019 and 2018, was $1,796,774 and $1,784,931, respectively. Additionally, the pass-through costs for the fiscal years ended September 30, 2019 and 2018, were $86,774 and $74,931, respectively. LSC has the right to terminate the lease by giving no less than 120-day prior written notice if 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.

NOTE 7 COMMITMENTS AND CONTINGENCIES (CONTINUED)

Future minimum lease payments are as follows:

Fiscal Year	Amount
2020	$ 1,710,000
2021	1,710,000
2022	1,710,000
2023	1,140,000
Total Minimum Lease Payments	$ 6,270,000

Conditional Grants

Subject to the grantees meeting the applicable terms and conditions, conditional grants awarded to date will become payable as follows:

Fiscal Year	Amount
2020	$ 14,657,799
2021	4,454,395
2022	1,240,297
Total conditional grants awarded to date and unpaid	20,352,491
Total conditional grants advanced to grantees	614,000
Grants pending completion of award to grantees	17,525,129
Total	$ 38,491,620

Advances of conditional grants are included in grants receivable on the statements of financial position.

Management expects the grantees will achieve the milestones set forth in the conditional grants and thus the grant amounts will ultimately be recognized as an expense in future years. Unpaid amounts will be funded by net assets with donor restrictions.

NOTE 8 SUBSEQUENT EVENTS

Subsequent to year-end, the World Health Organization declared the spread of Coronavirus Disease (COVID-19) a world pandemic. The COVID-19 pandemic is having significant effects on global markets, supply chains, businesses, and communities. Specific to LSC, it is expected that the virus will adversely impact the majority of the clients our grantees serve, resulting in a dramatic spike in the need for legal services for our nation's low-income population. The CARES Act (Coronavirus Aid, Recovery, and Economic Security Act) was signed into law on March 27, 2020, and included $50 million in emergency assistance to address the increase in services needed for LSC grantees. The issues that will be felt immediately include increased evictions and unemployment, lack of access to health care, and scams aimed at the elderly – all of which will require legal services to address. In addition, there will be an enormous cost for many of our grantees to enable them to work effectively remotely. Management believes LSC is taking appropriate actions to mitigate the negative impact. However, the full impact of COVID-19 is unknown and cannot be reasonably estimated as these events occurred subsequent to year-end and are still developing

We have evaluated subsequent events occurring after the statement of financial position date through April 21, 2020, the date the financial statements were available for issuance and determined that no additional disclosures are required

CliftonLarsonAllen LLP
CLAconnect.com

INDEPENDENT AUDITORS' 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*

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

We have audited, in accordance with the 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, the financial statements of Legal Services Corporation, which comprise the statement of financial position as of September 30, 2019, and the related statements of activities and changes in net assets, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated April 21, 2020.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Legal Services Corporation's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Legal Services Corporation's internal control. Accordingly, we do not express an opinion on the effectiveness of Legal Services Corporation's internal control.

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 a 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. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control described in the accompanying schedule of findings as item 2019-001 that we consider to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Legal Services Corporation's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

Legal Services Corporation’s Response to Findings

Legal Services Corporation’s response to the findings identified in our audit is described in the accompanying schedule of findings. Legal Services Corporation’s response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity’s internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity’s internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Greenbelt, Maryland
April 21, 2020

2019-001 – Net Asset Classification and Presentation

Type of Finding: Significant Deficiency of Internal Control Over Financial Reporting

Criteria or specific requirement: Accounting principles generally accepted in the United States of America use the terms "net assets with donor restrictions" and "net assets without donor restrictions" to clearly distinguish net assets that have donor stipulations from those that do not. Reporting net assets in two classifications, those with donor restrictions and those without donor restrictions, is the minimum classification scheme.

ASU 2016-14 provides new requirements for information about self-imposed limits on the use of assets and net assets and how those self-imposed limits affect liquidity. It requires that information about the amounts and purposes of board designations of net assets without donor restrictions be provided in the notes to or on the face of the financial statements. The following self-imposed limits are specifically mentioned:

- Resolutions to designate a portion of net assets without donor restrictions to function as an endowment (sometimes called board-designated endowment funds).

- Resolutions to designate a portion of net assets without donor restrictions for a specific future expenditure (called board-designated net assets).

- Resolutions to designate a portion of net assets with donor restrictions to function as a board-designated endowment fund. For example, in rare circumstances, the governing board may set aside for long-term investment donor-restricted contributions that the organization is unable to spend in the near term.

Condition: During the audit, we noted LSC did not have proper support or understanding of the source of the board designated net assets or the purpose of the designation. Management subsequently reclassified $2,540,070 of board designated net assets as of September 30, 2018, of which $2,032,571 was transferred to net assets with donor restriction.

Questioned Costs: None

Context: $2,032,571 of the board designated net assets related to recaptured grant funds which when received through the federal appropriation were recognized as net assets with donor restriction and, as such, if returned should replenish net assets with donor restriction.

Cause: In September 2018, shortly before the end of LSC's fiscal year, LSC's long-time (31 years) Comptroller/Treasurer unexpectedly took an extended leave of absence. LSC promptly hired an Interim Controller in October 2018. In February 2019, the Interim Comptroller was appointed as LSC's Chief Financial Officer and Treasurer. The board designated net assets were classified as such prior to October 2018. LSC has not maintained adequate documentation to support the limitations on the use of these funds and improperly classified amounts as board designated net assets.

Effect: The improper classification of the board designation resulted in inaccurate presentation of net assets between the "without donor restrictions" and "with donor restrictions" categories.

Repeat Finding: No

Recommendation: CLA recommends that LSC ensure all funds are properly tracked according to their donor-imposed restrictions or board designations and that documentation supporting the classifications is maintained.

Management Response and Corrective Action Plan: LSC's management concurs with the auditor's assessment of a significant deficiency related to the classification of net assets. Management takes seriously its obligation to present fairly, in all material respects, its financial position. As explained below, management concurs that LSC's historical accounting treatment for returned basic field programs funds was incorrect and management has corrected that treatment.

The annual appropriation for LSC includes funds designated by Congress "for basic field programs." Basic field programs funds must be used "to provide financial assistance to qualified programs furnishing legal assistance to eligible clients . . . ." 42 U.S.C. § 2996e(a)(1)(A). Thus, LSC must use "basic field programs" funds for grants to support legal aid work. LSC cannot use those funds for expenses of LSC grants management and oversight or the Office of Inspector General.

LSC recovers funds from basic field grants for a variety of reasons, including for disallowed costs or as unspent funds as part of the close out of a grant. Recovered basic field funds are available for funding the same range of activities as were the original funds awarded. Thus, LSC may not use those recovered funds for grants management and oversight or for the Office of Inspector General. Nor can LSC use those funds for grants unrelated to "provid[ing] financial assistance to qualified programs furnishing legal assistance to eligible clients . . . ." under the LSC Act. 42 U.S.C. § 2996e(a)(1)(A).

Consistent with these limitations, LSC has used returned funds for disaster relief. A disaster, either natural or manmade, may cause a basic field grantee to incur significant one-time costs for itself or for services to its client community. In order to avoid diversion of funds from normal year-to-year client services, LSC may provide additional basic field funds for the disaster-related expenses.

Although LSC's use of the returned funds was fully consistent with purpose for which the basic field program funds were awarded, LSC's accounting treatment for those returned funds did not accurately characterize those funds. LSC recorded the returned funds as "without donor restrictions" because the funds had been previously disbursed. Additionally, LSC labeled these funds as "Board designated." This was LSC's historical practice and had not been questioned by prior audit firms.

A little over a year ago, LSC's long-term Comptroller retired and new senior Finance leadership was brought on board. During this time, many of LSC's accounting policies and procedures have been reviewed and this process is still ongoing. LSC's management concurs with the auditor's assessment that the historical accounting treatment for returned grant funds was incorrect. When field grant program funds are returned, their use is restricted to "providing financial assistance to qualified programs furnishing legal assistance to eligible clients." The returned funds have not been designated and may not be designated by the Board for purposes inconsistent with this restriction.

The total amount reported as board designated in the 2018 financial statement was $2,540,000 of which $2,032,000 represented basic field grants recovered. LSC was unable to locate any documentation regarding when or for what purpose the Board may have designated the remaining $508,000 since the funds were from appropriations related to Management and Grants Oversight. This amount has been reclassified to funds without donor restrictions.

LSC will ensure that policies and procedures are clearly documented as to the proper accounting treatment and recording of returned field grant program funds and other appropriated returned funds.