



Inspector General
Kirt West

April 20, 2005

TO: Board of Directors
Legal Services Corporation

FROM: Kirt West *Kirt West*
Inspector General

SUBJECT: Transmittal of FY 2004 Financial Statement Audit Report

The Office of Inspector General (OIG) contracted with the independent certified public accounting firm of M.D. Oppenheim & Company, P.C. to audit the financial statements of the Legal Services Corporation (LSC) as of September 30, 2004 and 2003. The audit was conducted in accordance with auditing standards generally accepted in the United States of America, as well as the standards applicable to financial audits contained in the *Government Auditing Standards* issued by the Comptroller General of the United States.

The Independent Auditor's Report by M.D. Oppenheim, P.C. stated that LSC's financial statements present fairly, in all material respects, the financial position of LSC as of September 30, 2004 and September 30, 2003 and the results of its operations and changes in its fund balance for the years then ended in conformity with accounting principles generally accepted in the United States.

The Independent Auditor's Report on Compliance and Internal Control disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. This Report also noted no matters involving the internal control over financial reporting and its operation that were considered to be material weaknesses.

OIG reviewed M.D. Oppenheim & Company's report and related audit documentation and inquired of their representatives. Our review, as differentiated from an audit in accordance with generally accepted government auditing standards in the United States, was not intended to enable us to express, and we do not express, opinions on LSC's financial statements, or conclusions about compliance with applicable laws and regulations, or the effectiveness of internal controls. M.D. Oppenheim, P.C. is responsible for the

attached auditor's report dated January 28, 2005, along with the conclusions expressed in the report. However, OIG's review disclosed no instances in which M.D. Oppenheim & Company, P.C. did not comply, in all material respects, with generally accepted government auditing standards.

Attachment

LEGAL SERVICES CORPORATION

Financial Statements and Independent Auditors' Report

SEPTEMBER 30, 2004 and 2003

LEGAL SERVICES CORPORATION

SEPTEMBER 30, 2004 and 2003

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

INDEPENDENT AUDITORS' REPORT

We have audited the accompanying statements of net assets and governmental fund balance sheets of Legal Services Corporation ("LSC") as of September 30, 2004 and 2003 and the related statements of activities and governmental fund revenues, expenditures, and changes in fund balances for the years then ended. These financial statements are the responsibility of LSC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of LSC as of September 30, 2004 and 2003 and the results of its operations and changes in its fund balance for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis for the year ended September 30, 2004 on pages 3-11 is required supplementary information in accordance with the Governmental Accounting Standards Board and precedes the basic financial statements. We have applied certain limited procedures, which consisted principally of inquires of management regarding the methods of measurements and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 28, 2005 on our consideration of LSC's internal controls over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants.

Inspector General and Board of Directors
Legal Services Corporation
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That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of the audit.

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

January 28, 2005, except for Note J,
as to which the date is March 17, 2005

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis September 30, 2004

Overview of the Financial Statements

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

The Statement of Net Assets and Governmental Funds Balance Sheet reports the net assets available to pay outstanding liabilities. The resulting balance is the amount of funds available to support next year's operations. The next statement is titled Statement of Activities and Governmental Fund Revenues, Expenditures, and Changes in Fund Balances and provides the results of the current year's operations.

The LSC financial statements include one discretely presented component unit: the Friends of the Legal Services Corporation ("FoLSC"), a non-profit organization incorporated in the District of Columbia, which is a separate legal entity. FoLSC was formed in 2001 for the purposes of raising funds to provide support for all aspects of LSC's mission, and to acquire, hold, and manage assets for use by LSC, where doing so may result in lower costs or greater efficiencies for LSC. The results of FoLSC operations are available in separately issued financial statements.

Financial Highlights

LSC receives its support from federal appropriations and its derivative income, which are LSC's until expended, and a grant from the U.S. Court of Veterans Appeals. Any remaining funds from one year's budget are included in the next year's budget to support the next year's activities. Operations in 2004 yielded a decrease to the net assets in the amount of \$781,135. When this amount, which is shown in the Statement of Activities and Governmental Fund Revenues, Expenditures and Changes in Fund Balances, is added to the prior year's balance, the year-end net assets total \$3,693,143. This compares to the net assets increase in 2003 totaling \$1,551,029 and year-end net assets of \$4,474,278.

Financial Analysis of the Legal Services Corporation

The financial statements are a series of related reports that detail financial information using accounting methods similar to those used by other non-profit entities. When reviewing the following condensed Statement of Net Assets table for FY 2004, the difference between total assets and total liabilities is \$3,693,143, which compares to \$4,474,278 in FY 2003 (a reduction of \$781,135). Results of operations for September 30, 2004, show a fund balance of \$2,948,353; this compares to \$3,594,204 as of September 30, 2003. Net investment in capital assets in FY 2004 and FY 2003 total \$744,790 and \$880,074, respectively.

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis September 30, 2004

Table 1
Statement of Net Assets

	September 30	
	<u>2004</u>	<u>2003</u>
Total Current Assets and Other Assets	\$ 65,177,107	\$ 66,372,955
Net Property and Equipment	<u>744,790</u>	<u>880,074</u>
Total Assets	<u>\$ 65,921,897</u>	<u>\$ 67,253,029</u>
Grants and Contracts Payable	\$ 57,536,172	\$ 58,098,799
Other Liabilities	1,296,057	1,403,744
Deferred Revenue	<u>3,396,525</u>	<u>3,276,208</u>
Total Liabilities	62,228,754	62,778,751
Net Assets		
Fund Balances	2,948,353	3,594,204
Investment in Capital Assets	<u>744,790</u>	<u>880,074</u>
Total Net Assets	<u>3,693,143</u>	<u>4,474,278</u>
Total Liabilities and Net Assets	<u>\$ 65,921,897</u>	<u>\$ 67,253,029</u>

In 2004, Congressional appropriations, grant funds from the U.S. Court of Veterans Appeals, and other revenues totaled \$336,396,638, expenditures totaled \$337,177,773 that yielded deficit spending in the amount of \$781,135. This deficit is supported from the prior year's carryover that is reported as FY 2003 Fund Balance(s) in the Statement of Net Assets.

In 2003, revenues totaled \$339,288,374; expenditures for program activities and support activities were \$322,339,736 and \$15,397,609, respectively, which resulted in revenue over expenditures of \$1,551,029. Table 2 provides a concise review of each year's operating results.

In 2004 Program activities expenditures of \$321,531,556 are comprised of grants, contracts, and grant reimbursable expenditures that are presented in detail in the budget and expenditures information in Table 6, and Table 5 provides a breakdown of the supporting activities expenditures of \$15,646,217.

LEGAL SERVICES CORPORATION

**Management's Discussion and Analysis
September 30, 2004**

**Table 2
Change in Net Assets**

	Years ended September 30,	
	2004	2003
Revenue		
Federal appropriations	\$ 335,282,450	\$ 336,645,488
Grant revenue	1,181,030	1,062,060
General revenues		
Change in deferred revenue	(126,346)	1,448,933
Interest & Other income	59,504	131,893
Total revenue	336,396,638	339,288,374
Expenses		
Program activities	321,531,556	322,339,736
Supporting activities	15,646,217	15,397,609
Total expenses	337,177,773	337,737,345
Change in net assets	(781,135)	1,551,029
Net Assets, beginning of year	4,474,278	2,923,249
Net Assets, end of year	<u>\$ 3,693,143</u>	<u>\$ 4,474,278</u>

Capital Assets and Long-term Debt

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

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis September 30, 2004

Table 3
Capital Assets

	2004	2003
Furniture and Equipment	\$ 517,768	\$ 626,496
Software	59,001	68,505
Leasehold Improvements	168,021	185,073
Total Capital Assets (net)	\$ <u>744,790</u>	\$ <u>880,074</u>

General Fund Budgetary Analysis

As defined by the Legal Services Corporation Act, LSC's mission is to promote equal access to the system of justice and improve opportunities for low-income people throughout the United States by making grants for the provision of high-quality civil legal assistance to those who would be otherwise unable to afford legal counsel. To accomplish this mission, LSC established a multi-year strategic plan, called "Strategic Directions." To advance these Strategic Directions, LSC's budget process involves an approach to maximize the use of the available funds. To ensure that the goals set are being met, each Office Director reviews his/her office's monthly activities and expenditures, and at the end of each quarter, a formal review is completed that includes a projection of future fiscal year expenditures. The Treasurer /Comptroller and the LSC President evaluate this information and make necessary adjustments to ensure that the plans are in accord with the Strategic Directions. The LSC Inspector General heads an independent office of the Corporation and reports similar budget and operational activities, which is provided to the Treasurer/Comptroller.

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

The budgets included funding for the 2004 competition process for awarding of grants and the associated capability assessments, program quality visits throughout the year, which serve to gather important information regarding performance measures, and projects to promote diversity and leadership needs in the programs. Additionally, we continue to schedule 40 visits for our Office of Compliance and Enforcement (OCE) to conduct Case Service Reports/Case Management System reviews; A-50 audit finding and recommendation

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis September 30, 2004

referrals from the Office of Inspector General (OIG); Technical Assistance Reviews; and Training.

The OIG budget included funds activities in accord with the Inspector General Act and the LSC Appropriation. The OIG budget funded the review of LSC grantee audit reports and referrals of significant findings to LSC management for resolution, audits of grantees' compliance with LSC regulations concerning program integrity, audits of the private attorney involvement program, audit service reviews of grantee auditor work products, the LSC financial audit and the evaluation of mapping as a legal services management tool to improve program efficiency and effectiveness.

A combined budget presentation is shown in Table 4 and presents a comparison of the original and final revised operating budget for FY 2004.

Table 4
Original and Revised FY 2004 Operating Budget

<u>Budget Category</u>	<u>Original Budget</u>	<u>Final Budget</u>	<u>Variance</u>
Compensation and benefits	\$ 11,465,680	\$ 11,348,180	\$ 117,500
Temporary employee pay	154,115	212,115	(58,000)
Consulting	2,762,171	2,804,671	(42,500)
Travel and transportation expenses	1,027,475	978,975	48,500
Communications	197,550	214,550	(17,000)
Occupancy cost	1,747,150	1,747,400	(250)
Printing and reproduction	157,405	153,405	4,000
Other operating expenses	538,900	589,150	(50,250)
Capital expenditures	241,400	243,400	(2,000)
Total	<u>\$ 18,291,846</u>	<u>\$ 18,291,846</u>	<u>\$ -</u>

During the year, funds became available in the Compensation and Benefits budget category because of open positions and staff who were on extended leave without pay. Some of the Compensation and Benefits funds were moved to support temporary employees hired and consultants to continue the activities that aligned with the Strategic Directions, such as augmenting the state planning process, developing diversity and leadership initiatives, and writing articles for the Equal Justice Magazine while the regular positions were open.

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis September 30, 2004

The next table (Table 5) presents the final budget versus the expenditures for FY 2004, as well as the budget category variances. These variances result from a number of operating reasons. The main reason is the number of positions that were open. Because of the open positions, which included two from management and three senior positions in the Office of Program Performance, some projects that began early in the year were not completed and other planned activities that were budgeted were reduced in scope. Initiatives that were planned for the year will be undertaken next year. This created variances in the personnel compensation and benefits, consulting, and travel budget categories. Additional savings in the consulting and travel budget categories resulted from the Board's decision to complete the search for an Inspector General without benefit of an Executive Search Firm.

Also, the OIG had a carryover that was generated through cost savings related the Acting Inspector General functioning in two budgeted executive positions for three and three-quarter years and delayed filling of open staff positions. In FY 2005, \$1,000,000 of the OIG carryover may be used for an LSC managed Loan Repayment Assistance Program pilot study. Residual variances will be used to support next year's OIG activities.

The variances of the Basic Field Programs, U.S. Court of Veterans Appeals, and the Technology Initiatives are combined in the financial statements as Deferred Revenues. They are shown as Deferred Revenue because the projects are restricted by legislation, and are therefore considered unearned until the projects are completed.

The variance for Grants from Other Funds is monies that have been earmarked by the Board of Directors for special and/or emergency program needs; these funds are included in the restricted net assets total.

For budgeting purposes and full reporting to our Board of Directors and the public, there is a slight disconnect regarding the expenditures reported for budget purposes and the amount shown in the Statement of Activities because of Grant Recoveries. The difference is \$82,318, which is shown during the year as funds collected outside of the appropriation process. This process provides the Board with an opportunity to revise the budget to include the funds in the budget line, Grants from Other Funds. However, when the annual financial statements are completed, the total Grant Recoveries are used to offset Grants expenses in the Statement of Activities.

LEGAL SERVICES CORPORATION

**Management's Discussion and Analysis
September 30, 2004**

**Table 5
Operating Budget Versus Actual Expenditures**

<u>Budget Category</u>	<u>Final Budget</u>	<u>Expenditures</u>	<u>Variance</u>
Compensation and benefits	\$ 11,348,180	\$ 10,489,266	\$ 858,914
Temporary employee pay	212,115	140,445	71,670
Consulting	2,804,671	1,415,632	1,389,039
Travel and transportation expenses	978,975	758,622	220,353
Communications	214,550	198,924	15,626
Occupancy cost	1,747,400	1,719,033	28,367
Printing and reproduction	153,405	106,670	46,735
Other operating expenses	589,150	534,041	55,109
Capital expenditures	243,400	148,298	95,102
Subtotal	<u>\$ 18,291,846</u>	<u>15,510,931</u>	<u>2,780,915</u>
Depreciation & amortization		282,832	(282,832)
Loss on disposal of assets		750	(750)
Less: capitalized assets		<u>(148,298)</u>	<u>148,298</u>
Total		<u>\$ 15,646,215</u>	<u>\$ 2,645,631</u>

**Table 6
FY 2004 Program Budget Verus Actual**

	<u>Budget</u>	<u>Expenditures</u>	<u>Variance</u>
Basic Field Programs	\$ 316,763,210	\$ 315,578,624	\$ 1,184,586
U.S. Court of Veterans Appeals Funds	1,225,521	1,181,030	44,491
Grants From Other Funds	1,216,507	1,009,431	207,076
Technology Initiatives	6,012,235	3,844,789	2,167,446
	<u>\$ 325,217,473</u>	<u>\$ 321,613,874</u>	<u>\$ 3,603,599</u>

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis September 30, 2004

Future Events

LSC is in the fifth year of implementing its Strategic Directions 2000-2005; the principal goals of which are to increase access to justice and improve the quality of civil legal assistance provided to eligible clients.

LSC recognizes the importance of and continues to monitor its grantees for compliance with federal law and LSC regulations. Although the majority of onsite reviews by the Office of Compliance and Enforcement (OCE) are regulatory investigations, OCE also conducts technical assistance reviews, accountability trainings and new executive director training to help LSC-funded grantees understand and better comply with LSC regulations.

LSC continues its work on important initiatives to support its grantees and to improve the quality and accessibility of legal services for the indigent. Some of these efforts include program visits by the Office of Program Performance to discover methods and procedures for the delivery of legal assistance that may serve as models for other programs; efforts to promote intake systems that maximize client access to services; and the sharing of information through an LSC Resource Library to promote the use of innovative ideas and best practices among all LSC-funded programs.

LSC will also continue the use of technology to promote and facilitate access to civil legal services, particularly through self help efforts. LSC continues to provide a range of technological assistance to programs, including assistance in evaluating the effectiveness of technology projects, such as statewide websites, and support in the form of "circuit riders" who assist with technology infrastructure, intake, and self-help projects.

LSC will also focus on the quality of services provided by its grantees. LSC has agreed to work with the American Bar Association's ("ABA") Standing Committee on Legal Aid and Indigent Defendants and the National Legal Aid and Defender Association to review and update the current ABA *Standards for the Providers of Civil Legal Services to the Poor*, which were last revised in 1986. LSC will also review and update its internal Program Performance Criteria.

In an effort to determine how LSC can best help its grantees address the difficulties of recruiting and retaining staff attorneys who have substantial law school debt, LSC will work with a Task Force to develop and implement a Pilot Loan Repayment Assistance Program ("LRAP"). The Task Force is composed of individuals who have extensive experience and knowledge in LRAP and will help LSC design an LRAP Pilot Program to determine whether loan repayment assistance will facilitate the recruitment and retention of skilled staff by LSC grantees.

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis September 30, 2004

The OIG will perform audit, evaluation and investigative activities in accord with the Inspector General Act and the LSC Appropriation under the new Inspector General. In addition to carrying out our Congressional responsibility to oversee compliance with restrictions placed on grantees prohibiting certain activities, the OIG will begin reviewing the internal operations of the Corporation so that the Corporation will be effective and efficient in carrying out its mission.

LSC has focused its resources for FY 2005 to continue to advance these efforts. This year's appropriation net of rescissions is \$330,803,705. With this new funding and other funds from FY 2004 carryover, which includes restricted and unrestricted net assets and deferred revenue, projected FY 2005 income from interest and a grant from the United States Court of Veterans Appeals, LSC will have \$338,383,583 available to carry out its mandate for FY 2005.

Basic Financial Statements

LEGAL SERVICES CORPORATION
STATEMENT OF NET ASSETS AND GOVERNMENTAL FUND BALANCE SHEET
September 30, 2004

	General Fund	Adjustments (Note A)	Statement of Net Assets
ASSETS			
Cash and cash equivalents	\$ 65,018,956	\$	\$ 65,018,956
Accounts receivable	8,055		8,055
Prepaid expenses and deposits	150,096		150,096
Capital assets (net)		744,790	744,790
Total assets	\$ 65,177,107	\$ 744,790	\$ 65,921,897
LIABILITIES			
Grants and contracts payable	\$ 57,536,172	\$	\$ 57,536,172
Accounts payable	439,418		439,418
Accrued vacation and other liabilities	856,639		856,639
Deferred revenue	3,396,525		3,396,525
Total liabilities	62,228,754		62,228,754
FUND BALANCE/NET ASSETS			
Fund balances:			
Reserved	358,002		
Unreserved	2,590,351		
Total fund balances	2,948,353		
Total liabilities and fund balances	\$ 65,177,107		
Net assets:			
Invested in capital assets, net of related debt		744,790	744,790
Restricted		2,948,353	2,948,353
Total net assets		\$ 3,693,143	3,693,143
TOTAL LIABILITIES & NET ASSETS			\$ 65,921,897

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

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

Fund balance		\$	2,948,353
Capital assets used in governmental activities are not financial resources, and, therefore, are not reported in the fund financial statements			744,790
Total net assets		\$	3,693,143

See accompanying notes and Independent Auditors' Report.

LEGAL SERVICES CORPORATION
STATEMENT OF NET ASSETS AND GOVERNMENTAL FUND BALANCE SHEET
September 30, 2003

	General Fund	Adjustments (Note A)	Statement of Net Assets
ASSETS			
Cash and cash equivalents	\$ 66,157,906	\$	\$ 66,157,906
Accounts receivable	17,329		17,329
Prepaid expenses and deposits	197,720		197,720
Capital assets (net)		880,074	880,074
Total assets	\$ 66,372,955	\$ 880,074	\$ 67,253,029
LIABILITIES			
Grants and contracts payable	\$ 58,098,799	\$	\$ 58,098,799
Accounts payable	595,377		595,377
Accrued vacation and other liabilities	808,367		808,367
Deferred revenue	3,276,208		3,276,208
Total liabilities	62,778,751		62,778,751
FUND BALANCE/NET ASSETS			
Fund balances:			
Reserved	1,362,877		
Unreserved	2,231,327		
Total fund balances	3,594,204		
Total liabilities and fund balances	\$ 66,372,955		
Net assets:			
Invested in capital assets, net of related debt		880,074	880,074
Restricted		3,594,204	3,594,204
Total net assets		\$ 4,474,278	4,474,278
TOTAL LIABILITIES & NET ASSETS			\$ 67,253,029

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

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

Fund balance		\$ 3,594,204
Capital assets used in governmental activities are not financial resources, and, therefore, are not reported in the fund financial statements		880,074
Total net assets		\$ 4,474,278

See accompanying notes and Independent Auditors' Report.

LEGAL SERVICES CORPORATION
STATEMENT OF ACTIVITIES AND GOVERNMENTAL FUND REVENUES,
EXPENDITURES, AND CHANGES IN FUND BALANCES
Year ended September 30, 2004

	<u>General Fund</u>	<u>Adjustments (Note A)</u>	<u>Statement of Activities</u>
EXPENDITURES / EXPENSES			
Grants	\$ 321,531,556	\$	\$ 321,531,556
Board of Directors	218,126		218,126
Executive Office	471,894		471,894
Legal Affairs	949,908		949,908
Governmental Relations and Public Affairs	596,350		596,350
Human Resources	666,658		666,658
Financial and Administrative Services	2,629,162	(38,763)	2,590,399
Information Technology	1,163,253	(75,087)	1,088,166
Program Performance	2,873,268		2,873,268
Information Management	777,815		777,815
Compliance and Enforcement	2,433,789		2,433,789
Office of Inspector General	2,730,710	(33,698)	2,697,012
Depreciation / amortization		282,832	282,832
	<u>337,042,489</u>	<u>135,284</u>	<u>337,177,773</u>
PROGRAM REVENUES			
Federal Appropriation	335,282,450		335,282,450
U.S. Court of Veterans Appeals Funds	1,181,030		1,181,030
Change in deferred revenue	(126,346)		(126,346)
Total program revenue	<u>336,337,134</u>		<u>336,337,134</u>
GENERAL REVENUES			
Interest and other income	59,504		59,504
Total general revenues	<u>59,504</u>		<u>59,504</u>
Excess of revenues over expenditures	(645,851)	645,851	
Change in net assets		(781,135)	(781,135)
Fund balance/net assets:			
Beginning of the year	3,594,204		3,594,204
Invested in capital assets, net		880,074	880,074
End of the year	<u>\$ 2,948,353</u>	<u>\$ 744,790</u>	<u>\$ 3,693,143</u>

See accompanying notes and Independent Auditors' Report.

LEGAL SERVICES CORPORATION
STATEMENT OF ACTIVITIES AND GOVERNMENTAL FUND REVENUES,
EXPENDITURES, AND CHANGES IN FUND BALANCES
Year ended September 30, 2004

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

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

Excess of revenues over expenditures	\$	(645,851)
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Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays exceeded depreciation expense during the current period.		(135,284)
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Change in net assets	\$	(781,135)
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Fund balance:			
Beginning of year	\$	3,594,204	
Net change		(645,851)	
End of year		2,948,353	\$ 2,948,353

To include capital assets (net) used in governmental activities in the statement of activities, which are not reported in fund financial statements

Excess of revenues			
over expenditures		645,851	
Change in net assets		(781,135)	
Capital assets, beginning		880,074	
Capital assets (net)	\$	744,790	744,790

Total net assets	\$	3,693,143
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See accompanying notes and Independent Auditors' Report.

LEGAL SERVICES CORPORATION
STATEMENT OF ACTIVITIES AND GOVERNMENTAL FUND REVENUES
EXPENDITURES AND CHANGES IN FUND BALANCES
Year ended September 30, 2003

	<u>General Fund</u>	<u>Adjustments (Note A)</u>	<u>Statement of Activities</u>
EXPENDITURES / EXPENSES			
Grants	\$ 322,339,736	\$	\$ 322,339,736
Board of Directors	202,489		202,489
Executive Office	823,292		823,292
Legal Affaris	1,099,548		1,099,548
Governmental Relations & Public Affairs	685,458		685,458
Human Resources	496,205		496,205
Financial & Administrative Services	2,777,973	(73,988)	2,703,985
Information Technology	1,204,220	(178,948)	1,025,272
Program Performance	2,955,809	(8,870)	2,946,939
Information Management	732,886	(12,856)	720,030
Compliance & Enforcement	2,257,754		2,257,754
Office of Inspector General	2,289,481	(209,754)	2,079,727
Depreciation / Amortization		356,910	356,910
Total expenditures/expenses	<u>337,864,851</u>	<u>(127,506)</u>	<u>337,737,345</u>
PROGRAM REVENUES			
Federal Appropriation	336,645,488		336,645,488
U.S. Court of Veterans Appeals Funds	1,062,060		1,062,060
Change in deferred revenue	1,448,933		1,448,933
Total program revenue	<u>339,156,481</u>		<u>339,156,481</u>
GENERAL REVENUES			
Interest and other income	131,893		131,893
Total general revenues	<u>131,893</u>		<u>131,893</u>
Excess of revenues over expenditures	1,423,523	(1,423,523)	
Change in net assets		1,551,029	1,551,029
Fund balance/net assets:			
Beginning of the year	2,170,681		2,170,681
Invested in capital assets, net		752,568	752,568
End of the year	<u>\$ 3,594,204</u>	<u>\$ 880,074</u>	<u>\$ 4,474,278</u>

See accompanying notes and Independent Auditors' Report.

LEGAL SERVICES CORPORATION
STATEMENT OF ACTIVITIES AND GOVERNMENTAL FUND REVENUES
EXPENDITURES AND CHANGES IN FUND BALANCES
Year ended September 30, 2003

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

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

Change in net assets	\$	1,423,523
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Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays exceeded depreciation expense during the current period.

		<u>127,506</u>
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Change in net assets	\$	<u><u>1,551,029</u></u>
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Fund balance:

Beginning of year	\$	2,170,681		
Net change		<u>1,423,523</u>		
End of year		<u><u>3,594,204</u></u>	\$	3,594,204

To include capital assets (net) used in governmental activities in the statement of activities, which are not reported in fund financial statements

Excess of revenues				
over expenditures	\$	(1,423,523)		
Change in net assets		1,551,029		
Capital assets, beginning		<u>752,568</u>		
Capital assets (net)	\$	<u><u>880,074</u></u>	\$	880,074

Total net assets	\$	<u><u>4,474,278</u></u>
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See accompanying notes and Independent Auditors' Report.

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2004 and 2003

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

1. Reporting Entity: 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.

These financial statements present Legal Services Corporation (the primary government) and Friends of Legal Services Corporation (the component unit). As defined in Statement No. 39 of the Governmental Accounting Standards Board (GASB), component units are legally separate entities that are included in LSC's reporting entity because of the significance of their operating or financial relationships with LSC.

Friends of the Legal Services Corporation was incorporated under the Nonprofit Corporation Act in the District of Columbia in 2001. The purpose of this component unit is to raise and provide funds to support all aspects of the missions of the Legal Services Corporation. Friends of the Legal Services Corporation may also acquire, hold, and manage assets for use by LSC where doing so may result in lower costs or greater efficiencies for LSC. Friends of the Legal Services is a discretely presented component unit using the condensed financial statement approach in the disclosure notes. Separate financial statements of the component unit may be obtained from the Legal Services Corporation Comptroller. Friends of the Legal Services Corporation is reported as a discrete component unit due to the nature and significance of its relationship with the primary government such that exclusion would cause the reporting entity's financial statements to be incomplete.

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

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2004 and 2003

Note A - Summary of Significant Accounting Policies
2. Financial Statement Presentation (Continued)

GASB Statement No. 34 requires that governmental financial statements include a government-wide Statement of Net Assets and Statement of Activities (reporting LSC as a whole) and fund financial statements that include a Governmental Fund Balance Sheet and a Statement of Governmental Fund Revenues, Expenditures, and Changes in Fund Balances (reporting financial transactions of LSC's major fund). LSC is a special purpose government engaged in a single governmental program and as such may combine its fund financial statements with its government-wide statements. A summary reconciliation of the fund financial data with the government-wide data is presented on the combined financial statements.

LSC has no proprietary or fiduciary funds; therefore, no cash flows or fiduciary statements are presented.

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

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

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

4. *Cash and Cash Equivalents:* LSC's cash and cash equivalents includes a Fund Balance with U.S. Treasury of \$34,787,820 and \$34,220,523 at September 30, 2004 and 2003, respectively.

5. *Property and Equipment:* Capital assets are stated at cost and depreciated using the straight-line method over the estimated useful lives of the assets of five to ten years.

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

7. *Revenues:* The federal appropriations are reported as program revenue in the period expended. The appropriation remains available until expended.

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2004 and 2003

Note A - Summary of Significant Accounting Policies (Continued)

8. Fund Balance / Net Assets: The fund balance reserved, reports the fund balance that is legally identified for specific uses. The Board of Directors, through its fund allocation process, has designated \$358,002 and \$1,362,877 of the fund balance for continuing programs and administrative activities as of September 30, 2004 and 2003, respectively. Net assets are reported as restricted due to constraints imposed for their use by Congressional appropriation legislation.

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

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

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

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

NOTE B – CONCENTRATION OF CREDIT RISK:

LSC invests cash balances in excess of predefined target balances through repurchase agreements with two financial institutions. The following categories of credit risk disclose the level of custody credit risk assumed by LSC based upon how its deposits were insured or secured with collateral at September 30, 2004:

Category 1 – Insured by FDIC.

Category 2 – Uninsured but collateralized with securities held by the pledging financial institution's trust department in LSC's name.

Category 3 – Uninsured and uncollateralized.

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2004 and 2003

Note B – Concentration of Credit Risk (Continued)

Total bank balance	Custody Credit Risk Category			Total Carrying Value
	1	2	3	
\$30,688,137	\$ 196,720	\$ 18,397,000	\$ 12,094,417	\$ 30,229,135

NOTE C - EQUIPMENT:

Property and equipment consists of the following at September 30, 2004:

	Beginning Balance	Additions	Disposals	Ending Balance
Furniture and equipment	\$ 1,656,677	\$ 111,335	\$ (113,968)	\$ 1,654,044
Software	285,726	33,013		318,739
Leasehold improvements	205,637	3,950		209,587
Subtotal	2,148,040	148,298	(113,968)	2,182,370
Less: Accumulated depreciation	(1,267,966)	(282,832)	113,218	(1,437,580)
Capital assets (net)	\$ 880,074	\$ (134,534)	\$ (750)	\$ 744,790

Property and equipment consists of the following at September 30, 2003:

	Beginning Balance	Additions	Disposals	Ending Balance
Furniture and equipment	\$ 1,711,211	\$ 258,601	\$ (313,135)	\$ 1,656,677
Software	263,222	22,504		285,726
Leasehold improvements	296,120	205,637	(296,120)	205,637
Subtotal	2,270,553	486,742	(609,255)	2,148,040
Less: Accumulated depreciation	(1,517,985)	(356,911)	606,930	(1,267,966)
Capital assets (net)	\$ 752,568	\$ 129,831	\$ (2,325)	\$ 880,074

Depreciation expense for the years ended September 30, 2004 and 2003 are \$282,832 and \$356,910, respectively.

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2004 and 2003

NOTE D - GRANT REVENUE:

LSC was awarded grants from the U.S. Court of Veterans Appeals for the purpose of furnishing legal assistance to veterans. Grant revenue for the years ended September 30, 2004 and 2003 are \$ 1,181,030 and \$ 1,062,060, respectively.

NOTE E - GRANT AND CONTRACTS EXPENSE:

Grant funding provided to the Legal Services Corporation, pursuant to Public Law 107-77, was for basic field programs. Grant and contracts expense for the years ended September 30, 2004 and 2003 consists of the following:

	<u>2004</u>	<u>2003</u>
Basic field programs	\$ 315,578,624	\$ 317,413,951
U.S. Court of Veterans Appeals fund	1,181,029	1,062,060
Technology Initiatives	3,844,789	4,883,281
Grant from other funds	1,009,432	
Grant Recoveries	<u>(82,318)</u>	<u>(1,019,556)</u>
Totals	<u>\$ 321,531,556</u>	<u>\$ 322,339,736</u>

NOTE F - RETIREMENT PLANS:

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

The excess of total pension expense over the amount contributed by LSC and by LSC employees represents the amount which must be financed directly by OPM. LSC does not recognize in its financial statements these excess amounts as they are deemed to be immaterial. Several employees also participate in the Federal Employees Health Benefits plan ("FEHB"), also administered by the OPM. LSC pays the cost of current employees.

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2004 and 2003

Note F – Retirement Plans (Continued)

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

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

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

LSC's contributions to these plans for the years ended September 30, 2004 and 2003 were \$633,090 and \$679,725 respectively. These amounts are included in supporting activities for management and administration expenses.

LSC also offers a tax deferred annuity savings plan for eligible employees. No contributions are made to this plan by LSC.

NOTE G - LEASES:

1. Operating Leases: During FY 2003, LSC terminated an existing lease for its headquarters office space. The original lease term was June 1, 1992 through May 31, 2002, but was extended through May 31, 2007. Under the agreement, LSC had termination rights any time after May 2003 if certain conditions were met, and providing nine months notice. On August 30, 2002, LSC provided written notification of its intent to terminate. The lease was terminated June 1, 2003 and a lease termination fee in the amount of \$149,680 was paid.

On June 1, 2003, LSC commenced a lease agreement for new office space. The lease agreement provides for a non-escalating annual base rent for a 10-year term and has no obligation to pay a portion of building operating expenses. LSC has the right to terminate the lease by giving no less than 120-day prior written notice in the event that LSC does not receive an appropriation from Congress for administrative costs sufficient to cover LSC and its rental obligations for any period during the term of the lease. The lessor is the component unit, Friends of the Legal Services Corporation. Future minimum lease payments required under this lease are as follows:

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2004 and 2003

Note G - Leases (Continued)

	Amount
September 30, 2005	\$ 1,710,000
2006	1,710,000
2007	1,710,000
2008	1,710,000
2009	1,710,000
Thereafter	6,270,000
Total	\$ 14,820,000

Rental expense for the years ended September 30, 2004 and 2003 is \$1,710,000 and \$1,517,009, respectively.

NOTE H - CONTINGENCIES:

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

2. Claims: During 1999, three (one former and two current) employees filed charges with the District of Columbia Office of Human Rights alleging that LSC engaged in discriminatory employment practices. The claims request damages of \$2 million. LSC believes it has not violated any laws and that any loss would be substantially below the amounts sought. No amounts have been recorded in the financial statements for these contingent liabilities.

During 2004, three (one former and two current) employees also filed actions alleging unfair employment practices under the wage and hour laws and requested damages of \$1,151,475 plus unspecified costs. Management has indicated its intention to contest and defend against this suit. No amounts have been recorded in the financial statements for these contingent liabilities.

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2004 and 2003

NOTE I - COMMITMENTS:

1. LSC has commitments related to 5 consulting contracts for \$150,926 and 4 employment agreements for \$184,230 as of September 30, 2004.

NOTE J - COMPONENT UNIT CONDENSED FINANCIAL STATEMENTS:

Component unit information for Friends of the Legal Services Corporation, a non-profit corporation, is provided in the following condensed financial statements as of September 30, 2004 and 2003. Complete financial statements of the component unit may be obtained from the Legal Services Corporation Comptroller.

Condensed Statements of Net Assets
September 30, 2004 and 2003

Assets:	<u>2004</u>	<u>2003</u>
Cash, accounts receivable and other assets	\$ 3,396,357	\$ 3,619,630
Capital assets (net)	16,740,411	17,347,163
Total assets	<u>20,136,768</u>	<u>20,966,793</u>
Liabilities:		
Accounts payable and other current liabilities	225,984	285,104
Long-term liabilities		
Due within one year	794,945	939,327
Due after one year	15,639,362	16,050,096
Total liabilities	<u>16,660,291</u>	<u>17,274,527</u>
Net assets:		
Temporarily restricted	1,500,000	2,709,066
Unrestricted	1,976,477	983,200
Total net assets	<u>\$ 3,476,477</u>	<u>\$ 3,692,266</u>

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2004 and 2003

Note J – Component Unit Condensed Financial Statements (Continued)

Condensed Statements of Activities
Years Ended September 30, 2004 and 2003

Expenses:	2004	2003
Building operations	\$ 968,038	\$ 725,132
Mortgage interest expense	723,313	265,765
General and administrative	102,549	14,719
Other: depreciation and amortization	681,115	443,740
Total expenses	<u>2,475,015</u>	<u>1,449,356</u>
Revenues:		
Contributions	3,000	70,403
Rent	2,234,126	1,139,557
Interest	19,291	27,309
Other income	2,809	140
Total revenues	<u>2,259,226</u>	<u>1,237,409</u>
Excess of revenues over expenses	(215,789)	(211,947)
Net assets - beginning	<u>3,692,266</u>	<u>3,904,213</u>
Net assets - ending	<u>\$ 3,476,477</u>	<u>\$ 3,692,266</u>

NOTE K – OTHER MATTERS

Certain amounts in the prior year financial statements have been adjusted for comparative purposes to conform to the presentation in the current year.

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

**REPORT ON COMPLIANCE AND INTERNAL CONTROL
OVER FINANCIAL REPORTING BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

We have audited the financial statements of Legal Services Corporation as of and for the year ended September 30, 2004, and have issued our report thereon dated January 28, 2005. 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.

Compliance: 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 grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting: In planning and performing our audit, we considered LSC's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Inspector General and Board of Directors
Page 2

This report is intended solely for the information and use of the Inspector General, the Board of Directors and management and others within the organization. However this report is a matter of public record and its distribution is not limited.

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

January 28, 2005