

LEGAL SERVICES CORPORATION
FINANCIAL STATEMENTS
SEPTEMBER 30, 1998 and 1997
Together with Independent Auditors' Report

LEGAL SERVICES CORPORATION

SEPTEMBER 30, 1998 AND 1997

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INDEPENDENT AUDITOR'S REPORT

Inspector General and Board of Directors
Legal Services Corporation

We have audited the accompanying balance sheet of Legal Services Corporation (the Corporation) as of September 30, 1998 and the related statements of support, revenue and expenses and changes in fund balance, and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Corporation as of September 30, 1997, were audited by other auditors whose report dated, November 21, 1997, expressed an unqualified opinion on those statements.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Corporation as of September 30, 1998, and the results of its operations and changes in its fund balance and cash flows for the year then ended in conformity with generally accepted accounting principles.

In accordance with Government Auditing Standards, we have also issued reports dated November 25, 1998 on our consideration of the Corporation's internal control and on its compliance with laws and regulations.

November 25, 1998
Washington, D.C.

LEGAL SERVICES CORPORATION
BALANCE SHEETS
SEPTEMBER 30, 1998 AND 1997

	<u>1998</u>	<u>1997</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents (Note 3)	\$48,335,546	\$49,028,378
Accounts receivable	13,859	29,227
Prepaid expenses and deposits	<u>304,723</u>	<u>283,861</u>
Total current assets	<u>48,654,128</u>	<u>49,341,466</u>
PROPERTY AND EQUIPMENT		
Furniture and equipment	1,541,301	1,580,239
Less accumulated depreciation and amortization	<u>(907,689)</u>	<u>(1,090,059)</u>
Net property and equipment	<u>633,612</u>	<u>490,180</u>
Total Assets	<u>\$49,287,740</u>	<u>\$49,831,646</u>
LIABILITIES AND FUND BALANCES		
CURRENT LIABILITIES		
Grants and contracts payables	\$45,800,504	\$45,601,625
Accounts payables	722,240	638,524
Accrued vacation and other liabilities	403,641	285,781
Deferred rent credit - current portion (Note 9)	190,039	190,039
Deferred revenue	<u>8,635</u>	<u>17,932</u>
Total current liabilities	47,125,059	46,733,901
Deferred rent credit - non-current portion (Note 9)	<u>506,770</u>	<u>696,809</u>
Total liabilities	<u>47,631,829</u>	<u>47,430,710</u>
FUND BALANCES		
Federal appropriation (Notes 2 and 7)		
Designated	27,646	1,452,449
Undesignated	994,653	458,307
Net investment in property and equipment	<u>633,612</u>	<u>490,180</u>
Total fund balances	<u>1,655,911</u>	<u>2,400,936</u>
Total Liabilities and Fund Balances	<u>\$49,287,740</u>	<u>\$49,831,646</u>

The accompanying notes are in integral part of these financial statements.

LEGAL SERVICES CORPORATION

STATEMENTS OF SUPPORT, REVENUE AND EXPENSES AND
CHANGES IN FUND BALANCES
FOR THE YEARS ENDED SEPTEMBER 30, 1998 AND 1997

	<u>1998</u>	<u>1997</u>
SUPPORT AND REVENUE		
Federal appropriation	\$283,000,000	\$283,000,000
Grant revenue (Note 5)	1,685,329	1,148,722
Interest and other income	<u>318,048</u>	<u>380,938</u>
Total support and revenue	<u>285,003,377</u>	<u>284,529,660</u>
EXPENSES		
Program activities - grant and contracts (Note 6)	276,978,750	274,554,335
Supporting activities - management and administration (Note 7)	<u>8,769,652</u>	<u>8,595,682</u>
Total expenses	<u>285,748,402</u>	<u>283,150,017</u>
(Deficit) Excess of support and revenue (under) over expenses	(745,025)	1,379,643
Fund balances, beginning year	<u>2,400,936</u>	<u>1,021,293</u>
Fund balances, end of year	<u>\$ 1,655,911</u>	<u>\$ 2,400,936</u>

The accompanying notes are in part of these financial statements.

LEGAL SERVICES CORPORATION
STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED SEPTEMBER 30, 1998 AND 1997

	<u>1998</u>	<u>1997</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
(Deficit) Excess of support and revenue (under) over expenses	\$ (745,025)	\$ 1,379,643
Adjustments to reconcile excess of support and revenue over expenses to net cash provided by (used in) operating activities:		
Depreciation and amortization	198,076	168,438
Loss on disposal of assets	5,066	22,562
(Increase) Decrease in accounts receivables	15,368	(24,097)
(Increase) Decrease in prepaid expenses and deposits	(20,862)	36,878
Increase (Decrease) in grants and contracts payables	198,879	734,970
Increase (Decrease) in accounts payable	83,716	323,593
Increase (Decrease) in accrued vacation and other liabilities	117,860	13,425
(Decrease) in lease liability	-	(552,815)
Decrease in deferred rent credit	(190,039)	(200,378)
Decrease in deferred revenue	<u>(9,297)</u>	<u>(15,015)</u>
Net cash provided by (used in) operating activities	(346,257)	1,887,204
CASH FLOWS USED IN INVESTING ACTIVITIES:		
Purchase of fixed assets	<u>(346,575)</u>	<u>(422,591)</u>
Net increase (decrease) in cash	(692,832)	1,464,613
Cash and cash equivalents, beginning of year	<u>49,028,378</u>	<u>47,563,765</u>
Cash and cash equivalents, end of year	<u>\$ 48,335,546</u>	<u>\$ 49,028,378</u>
SUPPLEMENTAL DISCLOSURE OF NON CASH FLOW INVESTING ACTIVITIES:		
Write-off of fixed assets disposed of with related accumulated depreciation of \$380,446 and \$173,629, respectively	<u>\$ 385,513</u>	<u>\$ 196,191</u>

The accompanying notes are in integral part of these financial statements.

LEGAL SERVICES CORPORATION
NOTES TO FINANCIAL STATEMENTS

NOTE 1 - BACKGROUND AND PURPOSE OF THE CORPORATION

The Legal Services Corporation (the Corporation) 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 the Corporation is to provide financial support to independent organizations that directly provided legal assistance in noncriminal proceedings or matters to persons financially unable to afford such counsel.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of significant accounting policies utilized by the Corporation.

- ▶ **Basis of Accounting:** (fund accounting) - The accounts of the Corporation are maintained on the accrual basis of accounting. To ensure observance of limitations and restrictions placed on the use of resources, the accounts are maintained in accordance with the principles of fund accounting whereby resources are classified for accounting and reporting purposes into funds established to their activities and objectives.

The federal appropriations fund includes amounts received and expended in furtherance of the Corporation objective, including general operations. The property fund represents investments in property, equipment and computer software, net of accumulated depreciation and amortization. Capital assets purchases or proceeds from their sale are recorded by transfer from or to the federal appropriations fund. Separate accounts are maintained for each fund; however for reporting purposes they are combined in the accompanying financial statements.

Federal appropriations fund balances have been stated as either designated or undesignated. Designated fund balances represent amounts which have been earmarked by the Board of Directors for continuing programs and administrative activities. Undesignated fund balances represent appropriated federal carryover and other operating excess which are available for future use at the discretion of the Board of Directors.

- ▶ **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.

Note 2 - Summary of Significant Accounting Policies (Continued)

- ▶ **Support and Revenue:** The federal appropriations are deemed to be earned and reported as support and revenue in the period designated by Congress, as the amounts are specifically committed to grantees. The appropriation remains available until expended.
- ▶ **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 the Corporation for failure to comply with other regulatory requirements.
- ▶ **Grant 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 the Corporation for its fiscal year.
- ▶ **Property and Equipment:** Furniture and equipment is stated at cost and depreciated using the straight-line method over the estimated useful lives of the assets of five to ten years.
- ▶ **Income Taxes:** The Corporation 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. The Corporation had no unrelated business income for 1998 and 1997, and accordingly, no provision for income taxes has been made in the accompanying financial statements.

NOTE 3 - Cash and Cash Equivalents

Cash and Cash Equivalents consist of cash on deposit at financial institutions and undisbursed appropriations which constitute spending authority that remain available in the Corporation's account held by the U.S. Treasury. Cash consists of the following:

	<u>1998</u>	<u>1997</u>
Cash in Financial Institutions	\$25,519,768	\$24,584,339
Cash in U.S. Treasury	<u>22,815,778</u>	<u>24,444,039</u>
Total	<u>\$48,335,546</u>	<u>\$49,028,378</u>

NOTE 4 - GRANT REVENUE

The Corporation was awarded a grant from the Corporation for National Service for the purpose of sponsoring AmeriCorps program to implement model strategies in addressing the legal needs of poor communities. In addition, the Corporation was awarded a grant from the U.S. Court of Veterans Appeals for the purpose of furnishing legal assistance to veterans. Grant revenue from these sources for the years ended September 30, 1998 and 1997 were as follows:

	<u>1998</u>	<u>1997</u>
Corporation for National Service	\$ 886,032	\$ 443,918
U.S. Courts of Veterans Appeals	<u>799,297</u>	<u>704,804</u>
Total	<u>\$1,685,329</u>	<u>\$1,148,722</u>

NOTE 5 - GRANT AND CONTRACTS EXPENSE

Grant funding provided to the Legal Services Corporation, pursuant to Public Law 105-119, was for basic field programs. Grant and contracts expense consists of the following:

	<u>1998</u>	<u>1997</u>
Basic field programs	\$275,455,172	\$273,470,982
U.S. Court of Veterans Appeals fund	785,702	704,804
AmeriCorps program	886,032	443,918
Grant from other funds	15,905	56,514
Special emergency funds	13,595	10,239
Grant refunds	<u>(177,656)</u>	<u>(132,122)</u>
Total	<u>\$276,978,750</u>	<u>\$274,554,335</u>

NOTE 6 - MANAGEMENT AND ADMINISTRATION EXPENSES

Management and administration expenses consist of the following:

	<u>1998</u>	<u>1997</u>
Personnel compensation	\$ 5,523,696	\$ 5,186,777
Temporary employee pay	125,297	118,263
Consulting	769,707	843,191
Travel and transportation	324,324	282,342
Communications	95,196	99,051
Occupancy cost	849,824	1,327,932
Printing and reproduction	35,412	83,452
Other operating expenses	655,486	437,172
Capital expenditures	<u>534,143</u>	<u>449,093</u>
Subtotal	8,913,085	8,827,273
Depreciation and amortization	198,076	168,438
Loss on disposal of assets	5,066	22,562
Purchase of assets	<u>(346,575)</u>	<u>(422,591)</u>
Total	<u>\$ 8,769,652</u>	<u>\$ 8,595,682</u>

NOTE 7 - FUND BALANCES

The Board of Directors, through its fund allocation process, has designated \$27,646 and \$1,452,449 of the federal appropriations fund balance for continuing programs and administrative activities as of September 30, 1998 and 1997, respectively.

NOTE 8 - RETIREMENT PLANS

Pursuant to the Legal Services Corporation Act, all officers and employees hired before October 1, 1988 are participants in the Civil Service Retirements System, although they are neither officers nor employees of the federal government. The Corporation makes contributions at rates applicable to agencies of the federal government. Eligible employees may contribute up to 5% of their pretax earnings to the Federal Thrift Savings Plan.

All officers and employees hired after September 30, 1988 are ineligible for the Civil Service Retirement System, but are eligible to participate in the Corporation's pension and thrift plan, which is a tax deferred, annuity plan subject to Section 403(b) of the Internal Revenue Code. All employees not covered under the Civil Service Retirement System are eligible to participate. Individuals can make contributions up to the maximum permitted by law. The Corporation matches the first 1% contributed by the employee. In addition, the Corporation contributes 6% of each eligible employee's salary regardless of their participation to the maximum permitted under federal income tax rules.

Note 8 - Retirement Plans

The Corporation's contributions to these plans for fiscal years 1998 and 1997 were \$271,925 and \$258,698, respectively.

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

NOTE 9 - COMMITMENTS AND CONTINGENCIES

- ▶ **Leases:** The Corporation's lease for its headquarters office space provides for increase annual base rent based on consumer price index increases, and payment of a portion of the building operating expenses. The lease commenced on June 1, 1992 and includes two renewal options for five years each and also provides for rent abatement for the first twelve months of the lease term. Future minimum lease payments required under this lease are as follows:

September 30 - 1999		\$1,200,931
	2000	1,200,931
	2001	1,200,931
	2002	<u>800,621</u>
	Total	<u>\$4,403,414</u>

Total minimum future payments have not been reduced by \$733,424 of sublease rentals to be received in the future under a noncancellable sublease.

	<u>1998</u>	<u>1997</u>
Gross rental expense	\$1,012,124	\$1,124,476
Sublease income	<u>(178,488)</u>	<u>(157,253)</u>
Net rent expense	<u>\$ 833,636</u>	<u>\$ 967,223</u>

- ▶ **Litigation:** In April 1995, a judgement in the amount of \$224,600 plus pre-judgement interest was entered in the United States District Court for the District of Columbia (the Court) against the Corporation under Count II of a three-count complaint for damages by a former employee in connection with wrongful termination of an employment contract. The Corporation appealed the judgement to the U.S. Court of Appeals and deposited \$300,000 with the Clerk of the Court as security for the judgement and attorney's fees while it proceeded to appeal the Court's decision. A provision for the potential loss in the amount of \$300,000 was recorded in the financial statements for 1995.

In April 1996, judgement was reversed as to Count II. The case was remanded to the court for resolution of Count III. During 1997, the \$300,000 deposited with the Court was used to pay the plaintiff attorney's fee, awarded under Count I, of \$81,700 and the remaining balance, including interest, was refunded to the Corporation. The Corporation has recorded a liability for its maximum potential exposure as of September 30, 1998.

- ▶ **Grants and Contracts:** The Corporation receives its funding from appropriations by Congress and grants from federal agencies and, accordingly, may be subjected to audits from the respective agencies. In addition, the Corporation provides significant funding to several independent organizations which are subjected to their own independent audits.

The Corporation's management does not expect any significant adjustments as a result of audits from federal agencies, should they occur, or from the audit of the subgrantee independent organizations.

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

Inspector General and Board of Directors
Legal Services Corporation

We have audited the financial statements of Legal Services Corporation (the Corporation) as of and for the year ended September 30, 1998, and have issued our report there on dated November 25, 1998. We conducted our audit in accordance with generally accepted auditing standards 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 the Corporation's financial statements are free of material misstatement, we performed test 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 test 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 the Corporation'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.

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

November 25, 1998
Washington, D.C.