

LEGAL SERVICES CORPORATION



OFFICE OF INSPECTOR GENERAL

REPORT

FISCAL YEAR 2002 AUDIT OF THE CORPORATION

Report No. 03-04

JUNE 2003

May 21, 2003

Acting Inspector General and Board of Directors
Legal Services Corporation

In planning and performing our audit of the financial statements of Legal Services Corporation ("LSC") as of and for the year ended September 30, 2002, we considered LSC's internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on internal control.

However, during our audit we became aware of several matters that are opportunities for strengthening internal controls and operating efficiency. The following summarizes our comments and suggestions regarding those matters. (We previously reported on LSC's compliance and internal control over financial reporting in our report dated May 21, 2003). This letter does not affect our report dated May 21, 2003 on the financial statements of the Legal Services Corporation.

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

1. **Incomplete Books of Account for Component Unit (Friends of the LSC)**

Last year we recommended that LSC begin planning for the implementation of a new accounting standard, GASB No. 34. In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis - for State and Local Governments* that became effective in FY 2002 for LSC. The primary effect of this statement on LSC is to modify the form of its financial statements and include a section for management's discussion and analysis. GASB 34 also requires LSC, the primary government, to include in its financial statements the financial information related to its discrete component unit, Friends of Legal Services Corporation. However, because FY 2002 was the first year of operations for the Friends of Legal Services Corporation, the books and records were not complete which caused a delay in the preparation and release of LSC's audit report. We recommend that LSC work with the Board of Directors of the Friends of LSC to ensure that its financial reporting data is complete and received timely for inclusion in LSC's audit report.

2. **Fixed Asset Disposals**

During our audit last year, we noted LSC did not have adequate procedures in place for the disposal of its fixed assets. In FY 2002, we noted that disposal procedures were put in place but were not operating fully in compliance with LSC policy. LSC updated its Administrative Manual regarding asset disposals during this audit period, but still was not maintaining contemporaneous records of disposed assets with an approving signature.

Acting Inspector General and Board of Directors
Page 2

Without adequate procedures in place for asset disposals, LSC cannot properly safeguard its assets. When an asset is identified for disposal, donation, or transfer, a disposal document should be completed and approved. Authorization of a disposal should be independent of access to the fixed asset records.

This report is intended solely for the information and use of the Acting 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.

Sincerely,

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

June 25, 2003

TO THE BOARD OF DIRECTORS:

Enclosed is the audit report on the Legal Services Corporation's (LSC) Fiscal Year 2002 financial statements. The statements are in a different format than prior years because LSC implemented Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*. Statement No. 34 requires LSC to include a narrative description of the year's activities as supplemental information with the financial statements. In addition, the financial statements include disclosure of LSC's relationship with the Friends of LSC.

M.D. Oppenheim and Co. (Oppenheim), an independent public accounting firm, performed the audit under contract with the Office of Inspector General. Oppenheim issued an unqualified opinion on LSC's financial statements. In addition, Oppenheim issued a report on LSC's compliance with laws and regulations and its internal control over financial reporting. The reports did not identify any instances of noncompliance or material weaknesses in internal controls over LSC's financial reporting.

To fulfill our responsibilities under the Inspector General Act of 1978 for ensuring the quality of the audit work performed we:

- Reviewed the auditor's approach to and planning for the audit;
- Evaluated the qualifications and independence of the auditors;
- Monitored the audit progress; and
- Reviewed the working papers to determine if they supported the audit reports.

We concluded that Oppenheim performed the audit in accordance with *Government Auditing Standards* and the audit work provides a reliable basis for the opinion on LSC's Fiscal Year 2002 financial statements.



Leonard J. Koczur
Acting Inspector General

Enclosure

LEGAL SERVICES CORPORATION

Financial Statements and
Independent Auditors' Report

SEPTEMBER 30, 2002

LEGAL SERVICES CORPORATION

SEPTEMBER 30, 2002

TABLE OF CONTENTS

	<i>PAGE</i>
Independent Auditors' Report.....	1
Management's Discussion and Analysis	3
Statement of Net Assets and Governmental Fund Balance Sheet	11
Statement of Activities and Governmental Fund Revenues, Expenditures, and Changes in Fund Balances	12
Notes to the Financial Statements.....	14
Report on Compliance and Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards.....	23

Acting Inspector General and Board of Directors
Legal Services Corporation

INDEPENDENT AUDITORS' REPORT

We have audited the accompanying statement of net assets and governmental fund balance sheet of Legal Services Corporation ("LSC") as of September 30, 2002 and the related statement of activities and governmental fund revenues, expenditures, and changes in fund balances for the year 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 audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of LSC as of September 30, 2002 and the results of its operations and changes in its fund balance for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note A to the accompanying financial statements, in FY 2002 Legal Services Corporation adopted Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*.

The Management's Discussion and Analysis on pages 3–9 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 May 21, 2003 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. 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.

May 21, 2003
Silver Spring, Maryland

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis September 30, 2002

Overview of the Financial Statements

The financial reporting for Legal Services Corporation for FY 2002 uses a revised format as compared to previous years. This annual report presents LSC's financial activities and position in three parts: 1) management's discussion and analysis (this section), 2) the basic financial statements and 3) notes to the financial statements. Management's discussion and analysis introduces the basic financial statements and provides a quick review of the overall financial position.

The Statement of Net Assets and Governmental Fund 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 Revenue, Expenditures, and Changes in Fund Balances and provides the results of the current year's operation.

The financial statements of LSC include one discretely presented component unit, a separate legal entity, in its report, the Friends of the Legal Services Corporation ("FLSC"), a non-profit organization incorporated in the District of Columbia. FLSC 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 FLSC operations are available in separately issued financial statements.

Financial Highlights

LSC's receives 100% of its support from federal appropriations and its derivative income; the funds are LSC's until expended. Any remaining funds from one year's budget are included in the next year's budget to support the next year's activities. The result of operations in 2002 yielded an increase to net assets in the amount of \$724,350. 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 \$2,923,249.

Financial Analysis of the Legal Services Corporation

The financial statements of LSC 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 net assets table you will note that the difference between total assets and total liabilities is \$2,923,249. With the amount of \$752,568 subtracted for the investment in capital assets, this leaves \$2,170,681 to be used in the next year's operations after satisfying all outstanding liabilities and deferred revenues. This is the initial year for the implementation of Governmental Account Standard Board Statement 34.

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis (cont.) September 30, 2002

Because of this, comparative statements are not presented; however, in future years, a comparative analysis of data will be presented.

Table 1
Statement of Net Assets

Current and other assets	\$ 65,544,969
Capital assets (net)	<u>752,568</u>
Total assets	<u>66,297,537</u>
Grants and contracts payable	56,842,572
Other liabilities	1,789,515
Deferred revenue	<u>4,742,201</u>
Total liabilities	<u>63,374,288</u>
Net assets	
Investment in capital assets	752,568
Restricted	<u>2,170,681</u>
Total net assets	\$ <u>2,923,249</u>

Table 2
Change in Net Assets

Revenue	
Federal appropriations	\$ 329,300,000
Grant revenue	895,540
General revenues	
Change in deferred revenue	198,596
Interest and other income	<u>131,154</u>
Total revenue	<u>330,525,290</u>
Expenses	
Program activities	315,507,796
Support activities	<u>14,293,144</u>
Total expenses	<u>329,800,940</u>
Excess of revenue over expenses	724,350
Net assets, beginning of the year	<u>2,198,899</u>
Net assets, end of year	\$ <u>2,923,249</u>

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis (cont.) September 30, 2002

Table 2 provides a concise review of the operating year. The support from appropriations, grant funds from the U.S. Court of Veterans Appeals, and other revenues totaled \$330,525,290. The program activities of \$315,507,796 are for the grants, contracts and grant reimbursable expenses during the year and are shown in the budget and expenses information in Table 6. A breakdown of the supporting activities of \$14,293,144 is shown in Table 5. The combination of the expenses minus the revenue yielded an excess of support over expenses of \$724,350.

Capital Assets and Long-term Debt

Categories of capital assets are reported in Table 3. There is no long-term debt activity for Legal Services Corporation.

Table 3
Capital Assets (Net)

Furniture and equipment	\$	669,521
Software		<u>83,047</u>
Total	\$	<u>752,568</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 the LSC Board of Directors established Strategic Directions. The Strategic Directions state that:

1. By 2004, LSC will dramatically increase the provision of legal services to eligible persons.
2. By 2004, LSC will ensure that eligible clients are receiving appropriate and high-quality legal assistance.

To advance these Strategic Directions, LSC's budget process involves an approach to maximize the availability of funds. To ensure that the Strategic Directions are being met, each Vice President reviews their offices' monthly activities and expenditures, and at the end of each quarter a review is completed to include a projection of future spending. The President analyzes this information and then a report is prepared and presented to the Board of Directors with his recommendations. The LSC Inspector General reports directly to the

LEGAL SERVICES CORPORATION

**Management's Discussion and Analysis (cont.)
September 30, 2002**

Board of Directors and provides similar information for the Board. These combined presentations afford the Board an opportunity to review each office's budget versus actual expenses and operating projections and make internal budgetary adjustments to advance the Strategic Directions. The following table illustrates the original and revised operating budgets for FY 2002.

**Table 4
Original and Revised Operating Budgets**

<u>Budget Category</u>	<u>Original Budget</u>	<u>Final Budget</u>	<u>Variance</u>
Personnel compensation	\$ 8,052,475	\$ 8,122,250	\$ (69,775)
Personnel benefits	<u>2,377,575</u>	<u>2,156,315</u>	<u>221,260</u>
Total compensation/benefits	10,430,050	10,278,565	151,485
Temporary employee pay	348,200	345,628	2,572
Consulting	2,039,400	2,086,219	(46,819)
Travel/transportation expenses	1,063,081	1,076,148	(13,067)
Communications	157,800	181,300	(23,500)
Occupancy cost	1,421,500	1,377,700	43,800
Printing and reproduction	127,050	119,300	7,750
Other operating expenses	568,625	603,563	(34,938)
Property and equipment	<u>285,000</u>	<u>372,283</u>	<u>(87,283)</u>
Total	<u>\$ 16,440,706</u>	<u>\$ 16,440,706</u>	<u>\$ 0</u>

During the year, funds became available in the compensation and benefits budget category because of an increase in open positions. Other funds became available when the decision was made for LSC to move to 3333 K Street by June 2003, and it became unnecessary to complete some refurbishing and upgrades to the current office space. When these funds were identified, some of them were moved to support other activities that aligned with the Strategic Directions such as state planning through the hiring of additional consultants and increased travel. It was determined that if funds became available, LSC would upgrade some of the computers and servers; this was also accomplished.

LEGAL SERVICES CORPORATION

**Management's Discussion and Analysis (cont.)
September 30, 2002**

The next table shows the year-end operating budget versus the actual expenditures for the year and the under-budget or unexpended balances. These unexpended funds are derived for a number of reasons. Among those were the circumstances surrounding the pending nomination of a new Board of Directors and the need to conduct position searches for a new President and Inspector General. Funds were earmarked for those purposes in the FY 2002 budget that will remain available until needed. A number of positions that remained open during the year were funded in the budget; those positions have now been hired. Additionally, funds were provided to Friends of the Legal Services Corporation for legal costs that have now been reimbursed; this increased the consulting budget. These unexpended balances will be used to support next year's activities.

**Table 5
Operating Budget Versus Actual**

<u>Budget Category</u>	<u>Final Budget</u>	<u>Expenditures</u>	<u>Unexpended Balances</u>
Personnel compensation	\$ 8,122,250	\$ 7,780,059	\$ 342,191
Personnel benefits	<u>2,156,315</u>	<u>1,859,480</u>	<u>296,835</u>
Total compensation/benefits	10,278,565	9,639,539	639,026
Temporary employee pay	345,628	190,884	154,744
Consulting	2,086,219	1,214,312	871,907
Travel/transportation expenses	1,076,148	816,898	259,250
Communications	181,300	129,810	51,490
Occupancy cost	1,377,700	1,325,270	52,430
Printing and reproduction	119,300	88,737	30,563
Other operating expenses	603,563	522,688	80,875
Property and equipment	<u>372,283</u>	<u>312,996</u>	<u>59,287</u>
Subtotals	16,440,706	14,241,134	2,199,572
Depreciation and amortization		361,266	(361,266)
Loss on disposal of assets		386	(386)
Less: capitalized assets		<u>(309,642)</u>	<u>309,642</u>
Totals	<u>\$ 16,440,706</u>	<u>\$ 14,293,144</u>	<u>\$ 2,147,562</u>

LEGAL SERVICES CORPORATION

**Management's Discussion and Analysis (cont.)
September 30, 2002**

There were no adjustments to the grants budget lines after adoptions by the Board of Directors. The under-budget or unexpended balances 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, therefore unearned until the projects are completed.

The amount shown for grants from other funds are monies that have been earmarked for unanticipated and/or emergency program needs and are included in the restricted net assets total.

**Table 6
Program Budget versus Actual**

Programs	Budget	Expenditures	Unexpended Balances
Basic field programs	\$ 310,096,210	\$ 309,994,072	\$ 102,138
U.S. Court of Veterans Appeals fund	963,121	895,540	67,581
Grants from other funds	127,754	13,121	114,633
Technology Initiatives	<u>9,177,005</u>	<u>4,605,063</u>	<u>4,571,942</u>
Total	<u>\$ 320,364,090</u>	<u>\$ 315,507,796</u>	<u>\$ 4,856,294</u>

Future Events

In 2002, LSC facilitated and approved structural changes in nine states in order to develop more effective and economical legal services delivery systems. The continued work with consolidation of service areas and programs in many states has been designed to maximize economies of scale, evenly distribute access to services, and broaden the delivery of the services available to low-income clients. LSC also provides technical assistance to many states to assist them in planning and implementing the structural and service delivery changes necessary to achieve state planning goals.

LSC works on other initiatives to support its grantees and to improve the quality and accessibility of services, including the use of technology to promote and facilitate access to legal services. LSC continues to provide a broad range of technological assistance to programs, and focuses particular attention on projects designed to substantially increase access to legal services, such as the creation of statewide websites and technological projects that assist *pro se* litigants.

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis (cont.) September 30, 2002

Some of LSC's additional efforts include: continuing program visits to discover innovative procedures that may serve as models for other programs; working with newly reconfigured service areas to ensure the development of comprehensive delivery systems throughout enlarged geographic areas; training to legal services lawyers on the use of the internet and other resources for poverty law research; and attempts to address the large student debt loads that frequently dissuade new lawyers from pursuing careers in legal services programs. LSC also continues to monitor its grantees for compliance with federal law and LSC regulations, working closely with the Offices of Compliance and Enforcement and Inspector General.

LSC-funded programs helped address approximately one million civil legal matters relating to issues such as domestic violence, child custody and visitation rights, evictions, access to health care, bankruptcy, unemployment and disability claims, and many other issues that millions of low-income Americans face throughout their lives. Without LSC funding, many of these individuals would have no other source of legal assistance for these critical, and many times life-altering problems. It is LSC's goal to address many more of these issues that low-income Americans face.

LSC has focused its resources for FY 2003 to advance these Strategic Directions. The 2003 appropriation was \$338,848,000; however it was subject to a .65% rescission that amounted to \$2,202,512. This made \$336,645,488 of new appropriation available. With this new funding, the FY 2002 carryover, which includes restricted net assets and deferred revenue, projected FY 2003 income for interest and the Equal Justice Magazine and a grant from the United States Court of Veterans Appeals, the FY 2003 budget totals \$344,767,509.

Basic Financial Statements

LEGAL SERVICES CORPORATION
STATEMENT OF NET ASSETS AND GOVERNMENTAL FUND BALANCE SHEET
September 30, 2002

	General Fund	Adjustments (Note A)	Statement of Net Assets
ASSETS			
Cash and cash equivalents	\$ 65,061,615	\$	\$ 65,061,615
Due from employees	19,910		19,910
Prepaid expenses and deposits	463,444		463,444
Capital assets (net)		752,568	752,568
Total assets	65,544,969	752,568	66,297,537
LIABILITIES			
Grants and contracts payable	56,842,572		56,842,572
Accounts payable	707,122		707,122
Accrued vacation and other liabilities	1,082,393		1,082,393
Deferred revenue	4,742,201		4,742,201
Total liabilities	63,374,288		63,374,288
FUND BALANCE/NET ASSETS			
Fund balances:			
Reserved	407,607		
Unreserved	1,763,074		
Total fund balances	2,170,681		
Total liabilities and fund balances	\$ 65,544,969		
Net assets:			
Investment in capital assets, net of related debt		752,568	752,568
Restricted		2,170,681	2,170,681
Total net assets		\$ 2,923,249	\$ 2,923,249

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		\$ 2,170,681	
Capital assets used in governmental activities are not financial resources, and, therefore, are not reported in the fund financial statements		752,568	
Total net assets		\$ 2,923,249	

See accompanying notes and Independent Auditors' Report.

LEGAL SERVICES CORPORATION
STATEMENT OF ACTIVITIES AND GOVERNMENTAL FUND REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES
September 30, 2002

	General Fund	Adjustments (Note A)	Statement of Activities
EXPENDITURES / EXPENSES			
Grants	\$ 315,507,796	\$	\$ 315,507,796
Board of Directors	187,139		187,139
Executive Office	813,617		813,617
Legal Affairs	706,002		706,002
Governmental Relations and Public Affairs	633,349		633,349
Human Resources	501,395		501,395
Financial and Administrative Services	2,380,809	(37,291)	2,343,518
Information Technology	1,280,162	(183,492)	1,096,670
Program Performance	2,994,641		2,994,641
Information Management	794,042		794,042
Compliance and Enforcement	2,129,261		2,129,261
Office of Inspector General	1,820,717	(88,473)	1,732,244
Depreciation / amortization		361,266	361,266
Total expenditures/expenses	329,748,930	52,010	329,800,940
PROGRAM REVENUES			
Federal appropriation	329,300,000		329,300,000
U.S. Court of Veterans Appeals funds	895,540		895,540
Change in deferred revenue	198,596		198,596
Total program revenue	330,394,136		330,394,136
GENERAL REVENUES			
Interest and other income	131,154		131,154
Total general revenues	131,154		131,154
Excess of revenues over expenditures	776,360	(776,360)	-
Change in net assets		724,350	724,350
Fund balance/net assets:			
Beginning of the year	2,198,899		2,198,899
Adjustment for GASB 34 implementation	(804,578)	804,578	
End of the year	\$ 2,170,681	\$ 752,568	\$ 2,923,249

See accompanying notes and Independent Auditors' Report.

LEGAL SERVICES CORPORATION
STATEMENT OF ACTIVITIES AND GOVERNMENTAL FUND REVENUE, EXPENDITURES,
AND CHANGES IN FUND BALANCES
September 30, 2002

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

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

Excess of revenues over expenditures	\$	776,360
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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 depreciation exceeded capital outlays during the current period.		(52,010)
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Change in net assets		724,350
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Adjustment of net investment in capital assets for initial GASB-34 implementation

Fund balance:		
Beginning of year	\$	2,198,899
Net change		776,360
Adjustment		(804,578)
End of year		2,170,681
		2,170,681

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	(776,360)	
Change in net assets	724,350	
Adjustment	804,578	
Capital assets (net)	\$ 752,568	752,568

Total net assets	\$	2,923,249
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See accompanying notes and Independent Auditors' Report.

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2002

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. 14 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 generally accepted accounting principles (GAAP). The Governmental Accounting Standards Board (GASB) is responsible for establishing 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.

In June 1999, GASB unanimously approved Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*. LSC is required to implement this new standard for FY 2002. The adoption of Statement No. 34 required LSC to make several changes to the presentation of its basic financial statements and requires the presentation of LSC's Management's Discussion and Analysis ("MD&A"). The MD&A is considered to be required supplemental data and precedes the financial statements.

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2002

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. *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.

5. *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.

6. *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, 2002

Note A - Summary of Significant Accounting Policies (Continued)

7. 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 \$407,607 of the fund balance for continuing programs and administrative activities as of September 30, 2002. Net assets are reported as restricted due to constraints imposed for their use by Congressional appropriation legislation.

8. 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.

9. 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.

10. 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.

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

12. Concentration of Credit Risk: During the year, the cash balances in some bank accounts exceeded the \$100,000 limit insured by the Federal Deposit Insurance Corporation. Management believes any risk associated with this is minimal.

NOTE B - 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 LSC's account held by the U.S. Treasury. Cash at September 30, 2002, consists of the following:

Cash in financial institutions	\$	31,212,553
Cash in U.S. Treasury		33,849,062

Total	\$	65,061,615

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2002

NOTE C - PROPERTY AND EQUIPMENT:

Property and equipment consists of the following at September 30, 2002:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Disposals</u>	<u>Ending Balance</u>
Furniture and equipment	\$ 1,842,063	\$ 277,301	\$ (408,153)	\$ 1,711,211
Software	230,881	32,341		263,222
Leasehold improvements	296,120			296,120
Subtotal	<u>2,369,064</u>	<u>309,642</u>	<u>(408,153)</u>	<u>2,270,553</u>
Less: Accumulated depreciation	<u>(1,564,486)</u>	<u>(361,266)</u>	<u>407,767</u>	<u>(1,517,985)</u>
Capital assets (net)	<u>\$ 804,578</u>	<u>\$ (51,624)</u>	<u>\$ (386)</u>	<u>\$ 752,568</u>

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 year ended September 30, 2002 is \$ 895,540.

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 at September 30, 2002 consists of the following:

Basic field programs	\$ 309,994,072
U.S. Court of Veterans Appeals fund	895,540
Technology Initiatives	4,605,063
Grant from other funds	<u>13,121</u>
Total	<u>\$ 315,507,796</u>

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2002

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. 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 FY 2002 was \$625,324. 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.

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2002

NOTE G - LEASES:

1. Operating Leases: LSC's lease for its headquarters office space provides for increases in 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 also provided for rent abatement for the first twelve months of the lease term. This deferred rent credit is amortized over the life of the original lease. The lease was amended in November 2001 to extend it through May 2007. Future minimum lease payments required under this lease are as follows:

September 30, 2003	\$	1,433,415
2004		1,462,824
2005		1,492,767
2006		1,523,379
2007		<u>1,029,311</u>
Total	\$	<u>6,941,696</u>

LSC has termination rights under the lease at any time after May 2003 if certain conditions are met, and providing nine months notice. On August 30, 2002, LSC provided written notification of its intent to terminate its lease effective June 1, 2003. A lease termination fee will be paid in the amount of \$149,680 on May 1, 2003.

Net rental expense for the year ended September 30, 2002 is as follows:

Gross rental expense	\$	1,371,585
Adjustment for rent reconciliation		4,192
Deferred rent expense		(126,692)
Sublease income		<u>(137,587)</u>
Net rent expense	\$	<u>1,111,498</u>

2. Sublease: LSC's sublease of its headquarters office space provided for increases in annual base rent of 1.5%, and payment of any excess operating expenses or real estate taxes. The lease commenced on June 3, 1996 and expired in May 2002.

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2002

NOTE H - CONTINGENCIES:

1. Grants and Contracts: LSC 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, LSC provides significant funding to several independent organizations, which are subjected to their own independent audits and audits by LSC.

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

2. Claims: During 1999, three employees alleging that LSC engaged in discriminatory employment practices filed charges with the District of Columbia Office of Human Rights against LSC. The claims request damages of \$2 million. Management has indicated it plans to vigorously contest these charges. LSC believes it has not violated any laws and that any loss would be substantially below the \$2 million sought. No amounts have been recorded in the financial statements for this contingent liability.

NOTE I - COMMITMENTS:

1. LSC has commitments related to 10 consulting contracts for \$172,974, for 3 employment agreements for \$230,566, and an office lease termination fee for \$149,680 following written notification of its intent to terminate its lease, as of September 30, 2002.

2. LSC's lease agreement for its new headquarters office space will commence the earlier of (1) June 1, 2003 or (2) the date LSC occupies the premises for the normal conduct of its business. The lease agreement provides for a non-escalating annual base rent for a 10-year term. LSC has no obligation to pay a portion of building operating expenses. The lessor is the component unit, Friends of the Legal Services Corporation. Future minimum lease payments required under this lease are as follows:

September 30, 2003	\$	570,000
2004		1,710,000
2005		1,710,000
2006		1,710,000
2007		1,710,000
2008 and thereafter		9,690,000
Total	\$	<u>17,100,000</u>

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2002

Note I - Commitments (Continued)

LSC has termination rights under the lease by giving no less than 120 days prior written notice in the event that LSC does not receive an appropriation from Congress for administrative costs sufficient to cover LSC and rental obligations for any period during the term of the lease.

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, 2002. Complete financial statements of the component unit may be obtained from the Legal of Services Comptroller.

Condensed Statement of Net Assets

Assets:	
Cash, accounts receivable and other assets	\$ 3,042,415
Capital assets (net)	14,846,361
Total assets	17,888,776
Liabilities:	
Accounts payable and other current liabilities	203,860
Long-term liabilities	
Due within one year	80,560
Due after one year	13,864,173
Total liabilities	14,148,593
Net assets:	
Temporarily restricted	2,709,066
Unrestricted	1,031,117
Total net assets	\$ 3,740,183

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2002

Note J – Component Unit Condensed Financial Statements (Continued)

Condensed Statement of Activities

Expenses:	
Building operating	\$ 175,614
General and administrative	257,966
Other: depreciation and amortization	<u>88,501</u>
 Total expenses	 522,081
 Revenues:	
Contributions	4,085,305
Rent	145,384
Interest and other income	<u>31,575</u>
 Total revenues	 4,262,264
 Excess of revenues over expenses	 3,740,183
 Net assets - beginning	 <u>0</u>
 Net assets - ending	 <u>\$ 3,740,183</u>

Acting Inspector General and Board of Directors
Legal Services Corporation

**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, 2002, and have issued our report thereon dated May 21, 2003. 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 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 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. However, we noted other matters involving the internal control over financial reporting, which we have reported to management of LSC in a separate letter dated May 21, 2003.

Acting Inspector General and Board of Directors
Page 2

This report is intended solely for the information and use of the Acting 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.

May 21, 2003
Silver Spring, Maryland