
LEGAL SERVICES CORPORATION

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITOR'S REPORT**

SEPTEMBER 30, 1996 AND 1995

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INDEPENDENT AUDITOR'S REPORT

Inspector General
Legal Services Corporation

Board of Directors
Legal Services Corporation

We have audited the accompanying balance sheets of Legal Services Corporation (the Corporation) as of September 30, 1996 and 1995 and the related statements of support, revenue and expenses and changes in fund balances, and cash flows for the years 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 audits.

We conducted our audits 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 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 the Corporation as of September 30, 1996 and 1995, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

December 2, 1996
Washington, D.C.

LEGAL SERVICES CORPORATION
BALANCE SHEETS
SEPTEMBER 30, 1996 AND 1995

	<u>1996</u>	<u>1995</u>
ASSETS		
CURRENT ASSETS		
Cash (Note 3)	\$47,563,765	\$59,466,038
Accounts receivable	5,130	127,000
Prepaid expenses and deposits	<u>320,738</u>	<u>374,692</u>
Total current assets	<u>47,889,633</u>	<u>59,967,730</u>
PROPERTY AND EQUIPMENT		
Furniture and equipment	1,353,840	1,373,382
Less accumulated depreciation and amortization	<u>(1,095,250)</u>	<u>(1,058,892)</u>
Net property and equipment	<u>258,590</u>	<u>314,490</u>
Total Assets	<u>\$48,148,223</u>	<u>\$60,282,220</u>
LIABILITIES AND FUND BALANCES (DEFICIT)		
CURRENT LIABILITIES		
Grants and contracts payable	\$44,866,655	\$57,091,264
Accounts payable	314,931	337,569
Lease liability (Note 4)	552,815	-
Accrued vacation and other liabilities	272,356	1,140,056
Deferred rent credit - current portion (Note 10)	136,262	125,154
Deferred revenue	<u>32,947</u>	<u>35,777</u>
Total current liabilities	46,175,966	58,729,820
DEFERRED RENT CREDIT- NON-CURRENT PORTION (Note 10)	<u>950,964</u>	<u>1,327,476</u>
Total liabilities	<u>47,126,930</u>	<u>60,057,296</u>
COMMITMENTS AND CONTINGENCIES (Note 10)	-	-
FUND BALANCES (DEFICIT)		
Federal appropriation (Notes 2 and 5)		
Designated	265,733	181,952
Undesignated	496,970	(271,518)
Net investment in properties	<u>258,590</u>	<u>314,490</u>
Total fund balances	<u>1,021,293</u>	<u>224,924</u>
Total Liabilities and Fund Balances	<u>\$48,148,223</u>	<u>\$60,282,220</u>

The accompanying notes are an
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, 1996 AND 1995

	<u>1996</u>	<u>1995</u>
SUPPORT AND REVENUE		
Current year federal appropriation	\$278,000,000	\$400,000,000
Grant revenue (Note 6)	1,149,049	1,584,556
Interest and other income	<u>372,028</u>	<u>860,330</u>
Total support and revenue	<u>279,521,077</u>	<u>402,444,886</u>
EXPENSES		
Program activities - grants and contracts (Note 7)	270,317,759	391,575,065
Supporting activities - management and administration (Note 8)	<u>8,094,384</u>	<u>11,729,853</u>
Total expenses	<u>278,412,143</u>	<u>403,304,918</u>
Excess (Deficiency) of support and revenue over expenses before lease loss	1,108,934	(860,032)
Lease loss (Note 4)	<u>(312,565)</u>	<u>-</u>
Excess (Deficiency) of support and revenue over expenses	796,369	(860,032)
Fund Balance, Beginning of Year	<u>224,924</u>	<u>1,084,956</u>
Fund Balance, End of Year	<u>\$ 1,021,293</u>	<u>\$ 224,924</u>

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

LEGAL SERVICES CORPORATION
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED SEPTEMBER 30, 1996 AND 1995

	<u>1996</u>	<u>1995</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Excess (deficiency) of support and revenue over expenses	\$ 796,369	\$ (860,032)
Adjustments to reconcile excess (deficiency) of support and revenue over expenses to net cash used in operating activities:		
Depreciation and amortization	103,581	110,652
Loss on disposal of assets	6,074	6,139
Decrease in accounts receivable	121,870	122,351
Decrease in prepaid expenses and deposits	53,954	83,071
Decrease in grants and contracts payable	(12,224,609)	(8,136,338)
Increase (Decrease) in lease liability	552,815	(687,811)
Decrease in accounts payable	(22,638)	(193,110)
(Decrease) Increase in accrued vacation and other liabilities	(867,700)	831,756
Decrease in deferred rent credit	(365,404)	(125,154)
Decrease in deferred revenue	<u>(2,830)</u>	<u>(114,223)</u>
Net cash used in operating activities	(11,848,518)	(8,962,699)
CASH FLOWS USED IN INVESTING ACTIVITIES:		
Purchase of fixed assets	<u>(53,755)</u>	<u>(95,855)</u>
Net decrease in cash	(11,902,273)	(9,058,554)
Cash, Beginning of Year	<u>59,466,038</u>	<u>68,524,592</u>
Cash, End of Year	<u>\$47,563,765</u>	<u>\$59,466,038</u>

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

LEGAL SERVICES CORPORATION
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 1996 AND 1995

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 provide 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 of the Corporation.

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 according to their activities and objectives.

The federal appropriation fund includes amounts received and expended in furtherance of the Corporation's objectives, including general operations. The properties fund represents investment in property, equipment, and computer software, net of accumulated depreciation and amortization. Capital asset purchases or proceeds from their sale are recorded by transfers 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 appropriation 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 is available for future use at the discretion of the Board of Directors.

LEGAL SERVICES CORPORATION
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 1996 AND 1995

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.

Grants and Contracts to Recipients - Liabilities, expenses and revenue 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 1996 and 1995, and accordingly, no provision for income taxes has been made in the accompanying financial statements.

LEGAL SERVICES CORPORATION
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 1996 AND 1995

NOTE 3: CASH

Cash consists of the following at September 30:

	1996	1995
Cash in Financial Institutions	\$24,286,446	\$32,846,997
Cash in U.S. Treasury	<u>23,277,319</u>	<u>26,619,041</u>
Total	<u>\$47,563,765</u>	<u>\$59,466,038</u>

NOTE 4: LEASE LIABILITY

On December 2, 1996, the Corporation amended its Headquarters office lease agreement which resulted in a reduction of its office space. The lease amendment requires the Corporation to pay the costs relating to following elements:

- Rent differential
- Portion of construction and improvements requested by new tenant of the released space
- Portion of new tenant's brokerage commissions
- Total rent amount for the released office space during the new tenant's free rent period of 105 days

Expenses relating to the above amounted to \$312,565, net of an adjustment for the related deferred rent incentive and is reflected in the accompanying financial statements as of September 30, 1996.

NOTE 5: FUND BALANCES

The Board of Directors, through its fund allocation process, has designated \$265,733 and \$181,952 of the federal appropriation fund balance for continuing programs and administrative activities as of September 30, 1996 and 1995, respectively.

NOTE 6: GRANT REVENUE

The Corporation was awarded a \$660,833 grant from the Corporation for National Service for the purpose of sponsoring AmeriCorps programs to implement model strategies in addressing the legal needs of poor communities. During the year, the Corporation had received \$658,901 of the grant award and distributed \$658,333 to qualifying AmeriCorps programs and applied \$568 to administrative expenses.

LEGAL SERVICES CORPORATION
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 1996 AND 1995

NOTE 6: GRANT REVENUE (Continued)

In addition, the Corporation was awarded a grant of \$490,148 from the U.S. Court of Veterans Appeals for the purpose of furnishing legal assistance to veterans. During the year, the Corporation had received and distributed \$485,000 of the grant monies to qualifying grantees and applied \$5,148 to administrative expenses.

NOTE 7: GRANTS AND CONTRACTS EXPENSE

Grant funding provided to the Legal Services Corporation, pursuant to Public Law 104-134, was for basic field programs. Grants and contracts expense consists of the following:

	<u>1996</u>	<u>1995</u>
Basic field programs	\$269,312,594	\$367,545,681
Native American programs and components	-	8,914,918
Migrant programs and components	-	12,720,252
Law school clinics and recruitment	-	1,399,547
Supplemental field programs	-	1,274,000
U.S. Court of Veterans appeals funds	490,148	757,318
AmeriCorps programs	658,901	713,016
Regional training centers	-	711,000
National support	-	8,201,808
State support	-	9,428,387
Clearinghouse	-	985,000
Computer assisted legal research grants	-	582,000
Special emergency funds	11,943	146,373
Grant refunds	<u>(155,827)</u>	<u>(169,065)</u>
Total	<u>\$270,317,759</u>	<u>\$391,575,065</u>

LEGAL SERVICES CORPORATION
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 1996 AND 1995

NOTE 8: MANAGEMENT AND ADMINISTRATION EXPENSES

Management and administration expenses consist of the following:

	<u>1996</u>	<u>1995</u>
Personnel compensation	\$4,482,953	\$ 5,754,402
Temporary employee pay	154,731	25,935
Personnel benefits	690,966	1,327,956
Consulting	297,367	960,283
Travel and transportation	186,699	806,294
Communications	120,366	127,354
Occupancy costs	1,590,788	1,752,935
Printing and reproduction	71,818	110,891
Other operating expenses	367,682	355,083
Provision for loss (Note 10)	-	300,000
Capital expenditures	75,114	122,475
Other	<u>-</u>	<u>65,310</u>
Subtotal	8,038,484	11,708,918
Depreciation and amortization	103,581	110,651
Loss on disposal of assets	6,074	6,139
Purchase of assets	<u>(53,755)</u>	<u>(95,855)</u>
Total	<u>\$8,094,384</u>	<u>\$11,729,853</u>

NOTE 9: RETIREMENT PLANS

Pursuant to the Legal Services Corporation Act, all officers and employees hired before October 1, 1988 are participants in the Civil Service Retirement System, 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 earning 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 scheduled to work 1,000 hours or more and 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.

LEGAL SERVICES CORPORATION
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 1996 AND 1995

NOTE 9: RETIREMENT PLANS (Continued)

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.

The Corporation's contributions to these plans for fiscal years 1996 and 1995 were \$288,062 and \$356,510, 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 10: COMMITMENTS AND CONTINGENCIES

Leases - The Corporation lease for its headquarters office space provides for increased 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 a rent abatement for the first twelve months of the lease term.

Future minimum lease payments required under this lease are as follows:

<u>September 30,</u>	
1997	\$1,229,832
1998	1,215,288
1999	1,215,288
2000	1,215,288
2001	1,215,288
Thereafter	<u>810,192</u>
Total	<u>\$6,901,176</u>

Rent expense is as follows for the years ended September 30:

	<u>1996</u>	<u>1995</u>
Gross rental expense	\$1,410,119	\$1,294,476
Sublease income	<u>(107,452)</u>	<u>(292,900)</u>
Net rent expense	<u>\$1,302,667</u>	<u>\$1,001,576</u>

LEGAL SERVICES CORPORATION
NOTES TO FINANCIAL STATEMENTS
SEPTEMBER 30, 1996 AND 1995

NOTE 10: COMMITMENTS AND CONTINGENCIES (Continued)

Litigation - In April 1995, a judgment in the amount of \$224,600 plus pre-judgment 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 a wrongful termination of an employment contract. As of September 30, 1995, the Corporation was in the process of appealing the judgment and had deposited \$300,000 with the Clerk of the Court as security for the judgment while they proceeded to appeal the Court's decision. This amount included an estimate of \$75,000 for attorneys' fees which the plaintiff was entitled to under Count I. The accompanying financial statements for 1995 reflect a provision for the potential loss in the amount of \$300,000. In April 1996, the Court's judgment was reversed as to Count II. The case is currently in the process of being remanded to the Court for resolution of Count III, and the \$300,000 remained on deposit with the Court as of September 30, 1996.

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. At present, the Corporation'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.

**INDEPENDENT AUDITOR'S REPORT
ON COMPLIANCE WITH LAWS, REGULATIONS, CONTRACTS,
AND GRANTS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

Inspector General
Legal Services Corporation

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, 1996, and have issued our report thereon dated December 2, 1996.

We conducted our audit in accordance with generally accepted auditing standards and *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.

Compliance with laws, regulations, contracts, and grants applicable to the Corporation is the responsibility of the Corporation's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Corporation's compliance with certain provisions of laws, regulations, contracts and grants. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards*.

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.

December 2, 1996
Washington, D.C.

**INDEPENDENT AUDITOR'S REPORT
ON THE INTERNAL CONTROL STRUCTURE BASED ON AN AUDIT
OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE
WITH *GOVERNMENT AUDITING STANDARDS***

Inspector General
Legal Services Corporation

Board of Directors
Legal Services Corporation

We have audited the financial statements of the Legal Services Corporation (the Corporation) as of and for the year ended September 30, 1996 and have issued our report thereon dated December 2, 1996.

We conducted our audit in accordance with generally accepted auditing standards and *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.

The management of the Corporation is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgements by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the financial statements of the Corporation for the year ended September 30, 1996, we obtained an understanding of the internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities 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 structure and its operation that we consider to be material weaknesses as defined above.

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.

December 2, 1996
Washington, D.C.