

January 14, 2000

TO THE BOARD OF DIRECTORS

This letter transmits the audit report on the Legal Services Corporation's (LSC) Fiscal Year 1999 financial statements. The independent public accounting firm of Bert Smith and Company performed the audit under contract with the Office of Inspector General. The audit was conducted in accordance with *Government Auditing Standards*.

The auditors issued an unqualified opinion on LSC's statement of financial position as of September 30, 1999, and the related statements of operations and cash flows for the year then ended. The auditor also issued a report on LSC's system of internal control and its compliance with laws and regulations. No material weaknesses in internal controls over financial reporting and its operation were identified in this report. The auditor issued a separate letter that identifies findings and recommendations to strengthen LSC internal controls and improve operating efficiency. These findings do not affect the auditor's unqualified opinion on the financial statements.

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 Bert Smith and Company 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 1999 financial statements.

E.R. Quatrevaux
Inspector General

LEGAL SERVICES CORPORATION
FINANCIAL STATEMENTS
SEPTEMBER 30, 1999 and 1998
Together with Independent Auditor's Report

LEGAL SERVICES CORPORATION

SEPTEMBER 30, 1999 AND 1998

TABLE OF CONTENTS

	<i>PAGE</i>
Independent Auditor's Report	
Balance Sheets.....	2
Statements of Support, Revenue and Expenses and Changes in Fund Balance.....	3
Statements of Cash Flows	4
Notes to the Financial Statements	5
Report on Compliance and Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards.....	10

INDEPENDENT AUDITOR'S REPORT

Inspector General and Board of Directors
Legal Services Corporation

We have audited the accompanying balance sheets of Legal Services Corporation (the Corporation) as of September 30, 1999 and 1998 and the related statements of support, revenue and expenses and changes in fund balance, 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 audits 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 the Corporation as of September 30, 1999 and 1998 and the results of its operations and changes in its fund balance and cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with Government Auditing Standards, we have also issued a report dated November 26, 1999 on our consideration of the Corporation's compliance and internal controls over financial reporting.

Bert Smith and Company
November 26, 1999
Washington, D.C.

LEGAL SERVICES CORPORATION
BALANCE SHEETS
SEPTEMBER 30, 1999 AND 1998

	1999	1998
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents (Note 3)	\$51,674,689	\$48,335,546
Accounts receivable	25,117	13,859
Prepaid expenses and deposits	326,375	304,723
Total current assets	52,026,181	48,654,128
PROPERTY AND EQUIPMENT		
Furniture and equipment	1,909,657	1,541,301
Less accumulated depreciation and amortization	(1,054,665)	(907,689)
Net property and equipment	854,992	633,612
Total Assets	\$52,881,173	\$49,287,740
LIABILITIES AND FUND BALANCE		
CURRENT LIABILITIES		
Grants and contracts payable	\$48,639,453	\$45,800,504
Accounts payable	764,518	722,240
Accrued vacation and other liabilities	441,059	403,641
Deferred rent credit - current portion (Note 9)	190,038	190,039
Deferred revenue	22,808	8,635
Total current liabilities	50,057,876	47,125,059
Deferred rent credit - non-current portion (Note 9)	316,731	506,770
Total liabilities	50,374,607	47,631,829
FUND BALANCE		
Federal appropriation (Notes 2 and 7)		
Designated	438,231	27,646
Undesignated	1,213,343	994,653
Net investment in property and equipment	854,992	633,612
Total fund balance	2,506,566	1,655,911
Total Liabilities and Fund Balance	\$52,881,173	\$49,287,740

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

LEGAL SERVICES CORPORATION
STATEMENTS OF SUPPORT, REVENUE AND EXPENSES
AND CHANGES IN FUND BALANCE
FOR THE YEARS ENDED SEPTEMBER 30, 1999 AND 1998

	1999	1998
SUPPORT AND REVENUE		
Federal appropriation	\$300,000,000	\$283,000,000
Grant revenue (Note 4)	850,827	1,685,329
Interest and other income	<u>506,066</u>	<u>318,048</u>
Total support and revenue	<u>301,356,893</u>	<u>285,003,377</u>
EXPENSES		
Program activities:		
grant and contracts (Note 5)	289,976,566	276,978,750
Supporting activities:		
management and administration (Notes 6 and 8)	<u>10,529,672</u>	<u>8,769,652</u>
Total expenses	<u>300,506,238</u>	<u>285,748,402</u>
Excess (Deficit) of support and revenue over (under) expenses	850,655	(745,025)
Fund balance, beginning of year	<u>1,655,911</u>	<u>2,400,936</u>
Fund balance, end of year	<u>\$ 2,506,566</u>	<u>\$ 1,655,911</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, 1999 AND 1998

	1999	1998
CASH FLOWS FROM OPERATING ACTIVITIES:		
Excess (Deficit) of support and revenue (under) over expenses	\$ 850,655	\$ (745,025)
Adjustments to reconcile excess (deficit) of support and revenue over (under) expenses to net cash provided by (used in) operating activities:		
Depreciation and amortization	170,815	198,076
Loss on disposal of assets	41,878	5,066
(Increase) Decrease in accounts receivables	(11,258)	15,368
(Increase) Decrease in prepaid expenses and deposits	(21,652)	(20,862)
Increase in grants and contracts payables	2,838,949	198,879
Increase in accounts payable	42,278	83,716
Increase in accrued vacation and other liabilities	37,418	117,860
Decrease in deferred rent credit	(190,039)	(190,039)
Increase (Decrease) in deferred revenue	<u>14,173</u>	<u>(9,297)</u>
Net cash provided by (used in) operating activities	3,773,217	(346,258)
CASH FLOWS USED IN INVESTING ACTIVITIES:		
Purchase of fixed assets	<u>(434,074)</u>	<u>(346,574)</u>
Net increase (decrease) in cash	3,339,143	(692,832)
Cash and cash equivalents, beginning of year	<u>48,335,546</u>	<u>49,028,378</u>
Cash and cash equivalents, end of year	<u>\$ 51,674,689</u>	<u>\$ 48,335,546</u>
SUPPLEMENTAL DISCLOSURE OF NON CASH FLOW INVESTING ACTIVITIES:		
Write-off of fixed assets disposed of with related accumulated depreciation of \$48,358 and \$380,446, respectively	<u>\$ 123,074</u>	<u>\$ 385,513</u>

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

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 1999 AND 1998

NOTE 1 - NATURE OF THE CORPORATION: The Legal Services Corporation (the Corporation) is a private nonmembership 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's 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.

- < **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 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 are 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 1999 and 1998, 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:

	1999	1998
Cash in Financial Institutions	\$ 26,505,175	\$25,519,768
Cash in U.S. Treasury	<u>25,169,514</u>	<u>22,815,778</u>
Total	<u>\$ 51,674,689</u>	<u>\$48,335,546</u>

NOTE 4 - GRANT REVENUE: The Corporation 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, 1999 and 1998 are as follows:

	1999	1998
Corporation for National Service	\$ -	\$ 886,032
U.S. Court of Veterans Appeals	850,827	785,702
Change in Deferred Revenue - Special Emergency	<u>-</u>	<u>13,595</u>
Total	<u>\$ 850,827</u>	<u>\$1,685,329</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:

	1999	1998
Basic field programs	\$289,000,000	\$275,455,172
U.S. Court of Veterans Appeals fund	850,827	785,702
AmeriCorps program	-	886,032
Grant from other funds	214,500	15,905
Special emergency funds	-	13,595
Grant refunds	<u>(88,761)</u>	<u>(177,656)</u>
Total	<u>\$289,976,566</u>	<u>\$276,978,750</u>

NOTE 6 - MANAGEMENT AND ADMINISTRATIVE EXPENSES: Management and administrative expenses consist of the following:

	1999	1998
Personnel Compensation	\$ 6,136,806	\$5,523,699
Temporary Employee Pay	124,478	124,822
Consulting	1,157,569	769,709
Travel and Transportation	782,830	365,295
Communications	123,255	95,196
Occupancy Cost	1,252,000	1,159,007
Printing and Reproduction	35,780	35,386
Other Operating Expenses	530,006	305,828
Capital Expenditures	<u>608,329</u>	<u>534,143</u>
Subtotal	10,751,053	8,913,085
Depreciation and Amortization	170,815	198,076
Loss on Disposal of Assets	41,878	5,066
Purchase of Assets	<u>(434,074)</u>	<u>(346,575)</u>
Total	<u>\$10,529,672</u>	<u>\$8,769,652</u>

NOTE 7 - FUND BALANCE: The Board of Directors through its fund allocation process, has designated \$438,231 and \$27,646 of the federal appropriations fund balance for continuing programs and administrative activities as of September 30, 1999 and 1998, 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. Individuals can make contributions up to the maximum permitted by law. Prior to July 1, 1999, the Corporation matched the first 1% contributed by the employee, effective July 1 this percentage was increased to 2.51%. 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 1999 and 1998 were \$354,422 and \$271,925, respectively. These amounts are included in supporting activities for management and administration expenses.

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 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 and includes two renewal options for five years each and also provided for rent abatement for the first twelve months of the lease term. Future minimum lease payments required under this lease are as follows:

	1999	1998
September 30 - 2000	\$1,274,340	\$1,200,931
2001	1,274,340	1,200,931
2002	<u>849,560</u>	<u>800,621</u>
Total	<u>\$3,398,240</u>	<u>\$3,202,483</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.

	1999	1998
Gross rental expense	\$1,224,777	\$1,012,124
Sublease income	<u>(200,326)</u>	<u>(178,488)</u>
Net rent expense	<u>\$1,024,451</u>	<u>\$ 833,636</u>

- < **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 and audits by the Corporation.

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.

**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, 1999, and have issued our report thereon dated November 26, 1999. 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 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 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. However, we noted other matters involving the internal control over financial reporting, which we have reported to management of the Corporation in a separate letter dated November 26, 1999.

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.

Bert Smith and Company
November 26, 1999
Washington, D.C.