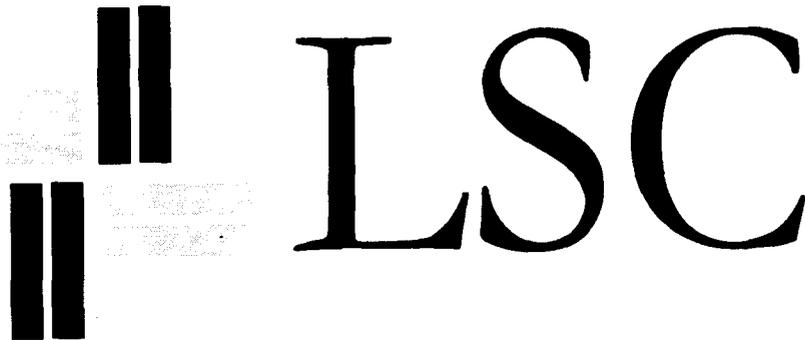


LEGAL SERVICES CORPORATION



OFFICE OF INSPECTOR GENERAL

REPORT

FISCAL YEAR 2003 AUDIT OF THE CORPORATION

Report No. AU04-04

APRIL 2004

April 26, 2004

TO THE BOARD OF DIRECTORS:

This letter transmits the audit report on the Legal Services Corporation's (LSC) Fiscal Year 2003 financial statements. The statements have the same format as the Fiscal Year 2002 financial statements when the LSC implemented Governmental Accounting Standards Board 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.

The independent public accounting firm of M.D. Oppenheim & Company, P.C. (Oppenheim) performed the audit under contract with the Office of Inspector General. Oppenheim issued an unqualified opinion on LSC's financial statements. Also, Oppenheim issued a report on LSC's compliance with laws and regulations and its internal controls 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 and planning for the audit;
- evaluated the qualifications and independence of the auditors;
- monitored the audit progress; and
- reviewed the audit documentation to determine whether they supported the audit report.

We concluded that Oppenheim performed the audit in accordance with *Government Auditing Standards*, and the audit work provided a reliable basis for the opinion on LSC's Fiscal Year 2003 financial statements.

A handwritten signature in black ink, appearing to read "Leonard J. Koczur", written in a cursive style.

Leonard J. Koczur
Acting Inspector General

LEGAL SERVICES CORPORATION

Financial Statements and Independent Auditors' Report

SEPTEMBER 30, 2003 and 2002

LEGAL SERVICES CORPORATION

SEPTEMBER 30, 2003 and 2002

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

INDEPENDENT AUDITORS' REPORT

We have audited the accompanying statements of net assets and governmental fund balance sheet of Legal Services Corporation ("LSC") as of September 30, 2003 and 2002 and the related statements of activities and governmental fund revenues, expenditures, and changes in fund balances for the years then ended. These financial statements are the responsibility of LSC's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of LSC as of September 30, 2003 and 2002 and the results of its operations and changes in its fund balance for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis for the year ended September 30, 2003 on pages 3-11 is required supplementary information in accordance with the Governmental Accounting Standards Board and precedes the basic financial statements. We have applied certain limited procedures, which consisted principally of inquires of management regarding the methods of measurements and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 7, 2004 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.

Acting Inspector General and Board of Directors
Legal Services Corporation
Page 2

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.

April 7, 2004

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis September 30, 2003

Overview of the Financial Statements

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

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 Balance and provides the results of current year's operation.

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

Financial Highlights

LSC's receives its support from federal appropriations and its derivative income, which are LSC's until expended, and a grant from the U.S. Court of Veterans Appeals. Any remaining funds from one year's budget are included in the next year's budget to support the next year's activities. The result of operations in 2003 yielded an increase to the net assets in the amount of \$1,551,029. 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 \$4,474,278. This compares to the net assets increase in 2002 totaling \$724,350 and year-end net assets of \$2,923,249.

LEGAL SERVICES CORPORATION

**Management's Discussion and Analysis
September 30, 2003**

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 \$4,474,278 as of September 30, 2003, which compares to \$2,923,249 at September 30, 2002. Net investment in capital assets in FY 2003 and FY 2002 totals \$880,074 and \$752,568, respectively. The results of operation as of September 30, 2003 shows a Fund Balance of \$3,594,204, compared to \$2,170,681 as of September 30, 2002.

**Table 1
Statement of Net Assets**

	September 30	
	2003	2002
Current and other assets	\$ 66,372,955	\$ 65,544,969
Net property and equipment	880,074	752,568
	-----	-----
Total assets	\$ 67,253,029	\$ 66,297,537
Grants and contracts payable	\$ 58,098,799	\$ 56,842,572
Other liabilities	1,403,744	1,789,515
Deferred revenue	3,276,208	4,742,201
	-----	-----
Total liabilities	62,778,751	63,374,288
Net assets		
Fund balance	3,594,204	2,170,681
Investment in capital assets	880,074	752,568
	-----	-----
Total net assets	4,474,278	2,923,249
	-----	-----
Total liabilities and net assets	\$ 67,253,029	\$ 66,297,537

LEGAL SERVICES CORPORATION

**Management's Discussion and Analysis
September 30, 2003**

**Table 2
Change in Net Assets**

	Years ended September 30,	
	2003	2002
Revenue		
Federal appropriations	\$ 336,645,488	\$ 329,300,000
Grant revenue	2,081,616	895,540
General revenues		
Change in deferred revenue	1,448,933	198,596
Interest and other income	131,893	131,154
	-----	-----
Total revenue	340,307,930	330,525,290
Expenses		
Program activities	323,359,292	315,507,796
Support activities	15,397,609	14,293,144
	-----	-----
Total expenses	338,756,901	329,800,940
Change in net assets	1,551,029	724,350
Net assets, beginning of the year	2,923,249	2,198,899
	-----	-----
Net assets, end of year	\$ 4,474,278	\$ 2,923,249

Table 2 provides a concise review of each year's operating results. In FY 2003, the support from appropriations, grant funds from the U.S. Court of Veterans Appeals, and other revenues totaled \$340,307,930. The program activities of \$323,359,292 comprised of grants, contracts, and grant reimbursable expenses, and are shown in detail in the budget and expenses information in Table 6. A breakdown of the supporting activities of \$15,397,609 is shown in Table 5. The combination of the revenue minus expenses yielded an excess of revenue over expenses of \$1,551,029. In FY 2002: support totaled \$330,525,290; expenses for program activities and support activities were \$315,507,796 and \$14,293,144, respectively, which resulted in revenue over expenses of \$724,350.

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis September 30, 2003

Capital Assets and Long-term Debt

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

Table 3
Capital Assets

	September 30,	
	2003	2002
Furniture and Equipment	\$ 626,496	\$ 669,521
Software	68,504	83,047
Leasehold Improvements	185,074	0
	-----	-----
Total Capital Assets (net)	\$ 880,074	\$ 752,568

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 Director's established a multi-year strategic plan, called "Strategic Directions" in January of 2000. The strategic plan states 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 goals set in the Strategic Directions are being met, each Vice President reviews his/her 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 prepares and presents a report to the Board of Directors with his recommendations. The LSC Inspector General reports directly to the 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 to make internal budgetary adjustments to advance the Strategic Directions. The following table illustrates the original and revised operating budget for FY 2003.

LEGAL SERVICES CORPORATION

**Management's Discussion and Analysis
September 30, 2003**

Table 4

Original and Revised FY 2003 Operating Budgets

<u>Budget Category</u>	<u>Original Budget</u>	<u>Final Budget</u>	<u>Variance</u>
Compensation/benefits	\$ 10,958,291	\$ 10,862,541	\$ 95,750
Temporary employee pay	254,499	316,299	(61,800)
Consulting	2,382,401	2,376,701	5,700
Travel/transportation expenses	1,066,345	1,055,895	10,450
Communications	219,841	250,491	(30,650)
Occupancy cost	1,548,000	1,546,000	2,000
Printing and reproduction	211,450	226,550	(15,100)
Other operating expenses	683,590	676,265	7,325
Capital expenditures	692,960	706,635	(13,675)
Total	\$ <u>18,017,377</u>	\$ <u>18,017,377</u>	\$ <u>0</u>

During the year, funds became available in the Compensation and Benefits budget category because of open positions and staff that were on extended leave without pay. When these funds were identified, some of them were moved to support other activities that aligned with the Strategic Directions, such as augmenting the state planning process by hiring temporary employees. Other funds were needed to support communications, printing and reproduction for the Equal Justice Magazine, and capital expenditures.

The next table shows the final budget versus the expenditures for FY 2003, as well as the unexpended balance. These unexpended funds are derived for a number of reasons. Among these were the circumstances surrounding the nomination of a new Board of Directors, and the need to conduct position searches for a new President and Inspector General. Additionally, a number of positions remained open during the year and a couple of staff members were on extended leave without pay. Some projects that began early in the year have not been completed. The unexpended balances will be used to support the continuation of these projections and support next year's activities.

LEGAL SERVICES CORPORATION

**Management's Discussion and Analysis
September 30, 2003**

**Table 5
FY 2003 Operating Budget versus Actual Expenditures**

<u>Budget Category</u>	<u>Final Budget</u>	<u>Expenditures</u>	<u>Unexpended Balance</u>
Compensation/benefits	\$ 10,862,541	\$ 10,031,026	\$ 831,515
Temporary employee pay	316,299	283,262	33,037
Consulting	2,376,701	1,469,059	907,642
Travel/transportation	1,055,895	858,433	197,462
Communications	250,491	182,875	67,616
Occupancy cost	1,546,000	1,529,406	16,594
Printing and reproduction	226,550	161,645	64,905
Other operating expenses	676,265	489,364	186,901
Capital expenditures	<u>706,635</u>	<u>522,546</u>	<u>184,089</u>
Subtotals	<u>\$ 18,017,377</u>	<u>15,527,616</u>	<u>2,489,761</u>
Depreciation and amortization		356,910	(356,910)
Loss on disposal of assets		(175)	175
Less: capitalized assets		<u>(486,742)</u>	<u>486,742</u>
Totals		<u>\$ 15,397,609</u>	<u>\$ 2,619,768</u>

There were no adjustments to the program budget lines after adoption by the Board of Directors. The 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 of Other Funds Available are monies that have been earmarked for unanticipated and/or emergency program needs, and are included in the restricted net assets total.

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis September 30, 2003

Table 6
FY 2003 Program Budget versus Actual

Programs	Budget	Expenditures	Unexpended Balances
Basic Field Programs	\$ 317,573,076	\$ 317,413,951	\$ 159,125
U.S. Court of Veterans Appeals Funds	1,112,581	1,062,060	50,521
Grants From Other Funds Available	1,028,996		1,028,996
Technology Initiatives	7,949,842	4,883,281	3,066,561
Total	<u>\$ 327,664,495</u>	<u>\$ 323,359,292</u>	<u>\$ 4,305,203</u>

Future Events

LSC facilitates and approves structural changes in states in order to develop more effective and economical legal services delivery systems. This work will continue with consolidation of some service areas and programs 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. Some of LSC's 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; and training to legal services lawyers on the use of the internet and other resources for poverty law research.

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

LSC has focused its resources for FY 2004 to continue to advance these efforts. The appropriation of \$338,848,000 was subject to two rescissions, which made the net

LEGAL SERVICES CORPORATION

**Management's Discussion and Analysis
September 30, 2003**

appropriation equal \$335,282,450. With this appropriation, the FY 2003 carryover that includes restricted and unrestricted net assets and deferred revenue, projected FY 2004 income from interest income and the Equal Justice Magazine and a grant from the United States Court of Veterans Appeals, LSC will be able to maintain effective operations.

Basic Financial Statements

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

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

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

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

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

See accompanying notes and Independent Auditors' Report.

LEGAL SERVICES CORPORATION
STATEMENT OF 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:			
Invested 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
TOTAL LIABILITIES AND NET ASSETS			\$ 66,297,537

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
Year ended September 30, 2003

	<u>General Fund</u>	<u>Adjustments (Note A)</u>	<u>Statement of Activities</u>
EXPENDITURES / EXPENSES			
Grants	\$ 323,359,292	\$	\$ 323,359,292
Board of Directors	202,489		202,489
Executive Office	823,292		823,292
Legal Affairs	1,099,548		1,099,548
Governmental Relations and Public Affairs	685,458		685,458
Human Resources	496,205		496,205
Financial and Administrative Services	2,777,973	(73,988)	2,703,985
Information Technology	1,204,220	(178,948)	1,025,272
Program Performance	2,955,809	(8,870)	2,946,939
Information Management	732,886	(12,856)	720,030
Compliance and Enforcement	2,257,754		2,257,754
Office of Inspector General	2,289,481	(209,754)	2,079,727
Depreciation / amortization		356,910	356,910
Total expenditures/expenses	<u>338,884,407</u>	<u>(127,506)</u>	<u>338,756,901</u>
PROGRAM REVENUES			
Federal Appropriation	336,645,488		336,645,488
U.S. Court of Veterans Appeals Funds	2,081,616		2,081,616
Change in deferred revenue	1,448,933		1,448,933
Total program revenue	<u>340,176,037</u>		<u>340,176,037</u>
GENERAL REVENUES			
Interest and other income	131,893		131,893
Total general revenues	<u>131,893</u>		<u>131,893</u>
Excess of revenues over expenditures	1,423,523	(1,423,523)	
Change in net assets		1,551,029	1,551,029
Fund balance/net assets:			
Beginning of the year	2,170,681		2,170,681
Invested in capital assets, net		752,568	752,568
End of the year	<u>\$ 3,594,204</u>	<u>\$ 880,074</u>	<u>\$ 4,474,278</u>

See accompanying notes and Independent Auditors' Report.

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

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

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

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

127,506

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

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

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

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

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

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

	<u>General Fund</u>	<u>Adjustments (Note A)</u>	<u>Statement of Activities</u>
EXPENDITURES / EXPENSES			
Grants	\$ 315,507,793	\$	\$ 315,507,793
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	2,380,812	(37,291)	2,343,521
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	<u>329,748,930</u>	<u>52,010</u>	<u>329,800,940</u>
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	<u>330,394,136</u>		<u>330,394,136</u>
GENERAL REVENUES			
Interest and other income	131,154		131,154
Total general revenues	<u>131,154</u>		<u>131,154</u>
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	<u>\$ 2,170,681</u>	<u>\$ 752,568</u>	<u>\$ 2,923,249</u>

See accompanying notes and Independent Auditors' Report.

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

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

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

Excess of revenues over expenditures	\$	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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Prior period adjustment of net investment in capital assets for initial GASB-34 implementation

Fund balance:		
Beginning of year	\$ 2,198,899	
Net change	776,360	
Prior period 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	
Prior period 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, 2003 and 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. 39 of the Governmental Accounting Standards Board (GASB), component units are legally separate entities that are included in LSC's reporting entity because of the significance of their operating or financial relationships with LSC.

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

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

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2003 and 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, 2003 and 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 \$1,362,877 and \$407,607 of the fund balance for continuing programs and administrative activities as of September 30, 2003 and 2002, respectively. 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, 2003 and 2002, consists of the following:

	<u>2003</u>	<u>2002</u>	
Cash in financial institutions	\$ 31,937,383	\$ 31,212,553	
Cash in U.S. Treasury	34,220,523	33,849,062	
Total	\$ 66,157,906	\$ 65,061,615	

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2003 and 2002

NOTE C - PROPERTY AND EQUIPMENT:

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

	Beginning Balance	Additions	Disposals	Ending Balance
Furniture and equipment	\$ 1,711,211	\$ 258,601	\$ (313,135)	\$ 1,656,677
Software	263,222	22,504		285,726
Leasehold improvements	296,120	205,637		501,757
Subtotal	2,270,553	486,742	(313,135)	2,444,160
Less: Accumulated depreciation	(1,517,985)	(356,911)	310,810	(1,564,086)
Capital assets (net)	<u>\$ 752,568</u>	<u>\$ 129,831</u>	<u>\$ (2,325)</u>	<u>\$ 880,074</u>

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

	Beginning Balance	Additions	Disposals	Ending Balance
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	2,369,064	309,642	(408,153)	2,270,553
Less: Accumulated depreciation	(1,564,486)	(361,266)	407,767	(1,517,985)
Capital assets (net)	<u>\$ 804,578</u>	<u>\$ (59,624)</u>	<u>\$ (386)</u>	<u>\$ 752,568</u>

Depreciation expense for the years ended September 30, 2003 and 2002 are \$356,910 and \$361,266, respectively.

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2003 and 2002

NOTE D - GRANT REVENUE:

LSC was awarded grants from the U.S. Court of Veterans Appeals for the purpose of furnishing legal assistance to veterans. Grant revenue for the years ended September 30, 2003 and 2002 are \$ 2,081,616 and \$ 895,540, respectively.

NOTE E - GRANT AND CONTRACTS EXPENSE:

Grant funding provided to the Legal Services Corporation, pursuant to Public Law 107-77, was for basic field programs. Grant and contracts expense for the years ended September 30, 2003 and 2002 consists of the following:

	<u>2003</u>	<u>2002</u>
Basic field programs	\$ 317,413,951	\$ 309,994,072
U.S. Court of Veterans Appeals fund	1,062,060	895,540
Technology Initiatives	4,883,281	4,605,063
Grant from other funds		13,121
Totals	<u>\$ 323,359,292</u>	<u>\$ 315,507,796</u>

NOTE F - RETIREMENT PLANS:

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

The excess of total pension expense over the amount contributed by LSC and by LSC employees represents the amount which must be financed directly by OPM. LSC does not recognize in its financial statements these excess amounts as they are deemed to be immaterial.

Several employees also participate in the Federal Employees Health Benefits plan ("FEHB"), also administered by the OPM. LSC pays the cost of current employees. Post-retirement

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2003 and 2002

Note F – Retirement Plans (Continued)

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

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

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

LSC's contributions to these plans for the years ended September 30, 2003 and 2002 were \$679,725 and \$625,324 respectively. These amounts are included in supporting activities for management and administration expenses.

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

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2003 and 2002

NOTE G - LEASES:

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

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

	<u>Amount</u>
September 30, 2004	\$ 1,710,000
2005	1,710,000
2006	1,710,000
2007	1,710,000
2008	1,710,000
Thereafter	<u>7,980,000</u>
Total	<u>\$ 16,530,000</u>

Rental expense for the years ended September 30, 2003 and 2002 is \$1,517,009 and \$1,111,498, respectively.

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2003 and 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 5 consulting contracts for \$343,581, and 3 employment agreements for \$166,378 as of September 30, 2003.

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2003 and 2002

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, 2003 and 2002. Complete financial statements of the component unit may be obtained from the Legal Services Corporation Comptroller.

Condensed Statement of Net Assets
September 30, 2003 and 2002

Assets:	<u>2003</u>	<u>2002</u>
Cash, accounts receivable and other assets	\$ 3,592,130	\$ 3,042,415
Capital assets (net)	17,182,175	14,845,403
Total assets	<u>20,774,305</u>	<u>17,887,818</u>
Liabilities:		
Accounts payable and other current liabilities	285,104	203,860
Long-term liabilities		
Due within one year	250,000	44,845
Due after one year	16,711,923	13,899,888
Total liabilities	<u>17,247,027</u>	<u>14,148,593</u>
Net assets:		
Temporarily restricted	2,709,066	2,709,066
Unrestricted	818,212	1,030,159
Total net assets	<u>\$ 3,527,278</u>	<u>\$ 3,739,225</u>

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2003 and 2002

Note J – Component Unit Condensed Financial Statements (Continued)

Condensed Statement of Activities
Years Ended September 30, 2003 and 2002

Expenses:	<u>2003</u>	<u>2002</u>
Building operating	\$ 725,132	\$ 141,927
Mortgage interest expense	265,765	33,202
General and administrative	14,719	258,453
Other: depreciation and amortization	443,740	89,457
Total expenses	<u>1,449,356</u>	<u>523,039</u>
Revenues:		
Contributions	70,403	4,085,305
Rent	1,139,557	160,609
Interest	27,309	9,066
Other income	140	7,284
Total revenues	<u>1,237,409</u>	<u>4,262,264</u>
Excess of revenues over expenses	(211,947)	3,739,225
Net assets - beginning	<u>3,739,225</u>	<u>0</u>
Net assets - ending	<u>\$ 3,527,278</u>	<u>\$ 3,739,225</u>

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

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

We have audited the financial statements of Legal Services Corporation as of and for the year ended September 30, 2003, and have issued our report thereon dated April 7, 2004. 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 April 7, 2004.

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.

April 7, 2004

April 7, 2004

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, 2003, 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 a matter that is an opportunity for strengthening internal controls and operating efficiency. The following summarizes our comments and suggestions regarding this matter. (We previously reported on LSC's compliance and internal control over financial reporting in our report dated April 7, 2004). This letter does not affect our report dated April 7, 2004 on the financial statements of the Legal Services Corporation.

We will review the status of this comment during our next audit engagement. We have already discussed this comment and suggestion with various LSC personnel, and we will be pleased to discuss it in further detail at your convenience, to perform any additional study of this matter, or to assist you in implementing the recommendations.

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

Statement No. 34 of the Governmental Accounting Standards Board 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. In FY 2002 we reported that because the books and records of the Friends of LSC were not complete at the time of the LSC audit, it caused a delay in the preparation and release of LSC's audit report. In FY 2003 we found that the timely closing of the Friends of LSC books continues to be a problem. This year it was due to untimely receipt of the Friends of LSC bond issue documentation. We recommend that LSC continue to work with the Board of Directors of the Friends of LSC to ensure that its financial information is complete and the books of account are closed timely in order to facilitate the timely completion and issue of LSC's annual audit report.

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.