Legal Services Corporation
Office of Inspector General

LSC

MEMORANDUM

TO: Board of Directors
Legal Services Corporation

FROM: Kirt West Kirt West
Inspector General

SUBJ: Transmittal of FY 2005 Financial Statement Audit Report

DATE: March 31, 2006

The Office of Inspector General (OIG) contracted with the independent certified public accounting firm of M.D. Oppenheim & Company, P.C. to audit the financial statements of the Legal Services Corporation (LSC) as of September 30, 2005 and 2004. The audit was conducted in accordance with auditing standards generally accepted in the United States of America, as well as the standards applicable to financial audits contained in the *Government Auditing Standards* issued by the Comptroller General of the Unites States.

The Independent Auditor's Report by M.D. Oppenheim, P.C. stated that LSC's financial statements present fairly, in all material respects, the financial position of LSC as of September 30, 2005 and September 30, 2004 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.

The Independent Auditor's Report on Compliance and Internal Control disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. This Report also noted no matters involving the internal control over financial reporting and its operation that were considered to be material weaknesses.

The OIG reviewed M.D. Oppenheim & Company's report and related audit documentation and inquired of their representatives. Our review, as differentiated from an audit in accordance with generally accepted government auditing standards in the United States, was not intended to enable us to express, and we do not express, opinions on LSC's financial statements, or

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conclusions about compliance with applicable laws and regulations, or the effectiveness of internal controls. M.D. Oppenheim, P.C. is responsible for the attached auditor's report, dated December 15, 2005, along with the conclusions expressed in the report.

However, OIG's review disclosed no instances in which M.D. Oppenheim & Company, P.C. did not comply, in all material respects, with generally accepted government auditing standards.

Attachment

cc: Helaine Barnett
President

Victor Fortuno
Vice President for Legal Affairs

LEGAL SERVICES CORPORATION

Financial Statements and
Independent Auditors' Report

SEPTEMBER 30, 2005 and 2004

M.D. OPPENHEIM & COMPANY, P.C.
CERTIFIED PUBLIC ACCOUNTANTS

LEGAL SERVICES CORPORATION

SEPTEMBER 30, 2005 and 2004

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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 sheets of Legal Services Corporation ("LSC") as of September 30, 2005 and 2004 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 audits.

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, 2005 and 2004 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, 2005, on pages 3–14 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 December 15, 2005 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 grant agreements and other matters.

The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. 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.

December 15, 2005

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis
For Year Ending September 30, 2005

Overview of the Financial Statements

The annual financial report presents the LSC's financial performance and position in three parts: 1) management's discussion and analysis; 2) the basic financial statements; and 3) notes to the financial statements.

Part 1, Management's Discussion and Analysis, provides a useful overview of LSC's financial position with respect to assets and an overview of the FY 2005 operating budget experience.

Part 2, the Basic Financial Statements, includes two financial statements: the Statement of Net Assets and Governmental Fund Balance Sheet; and the Statement of Activities and Governmental Fund Revenues, Expenditures, and Change in Fund Balance. These statements are presented for the periods ending September 30, 2005 and 2004, for the readers to be able to compare year-to-year balances. The financial statements are presented in accordance with accounting principles generally accepted in the United States of America as promulgated by the Governmental Accounting Standard Board.

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 Statement of Activities and Governmental Fund Revenues, Expenditures, and Changes in Fund Balance provides the results of the identified year's operations.

Part 3, Notes to the Financial Statements, provides further details on specific items contained in the statements in Part 2.

Financial Highlights

LSC receives its support from federal appropriations and its derivative income 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. Operations in 2005 yielded an increase to the net assets in the amount of $280,554. When this amount, which is shown in the Statement of Activities and Governmental Fund Revenues, Expenditures and Changes in Fund Balance, is added to the prior year's balance, the year-end net assets total $3,973,697. This compares to the decrease in net assets in 2004 of $781,135 which resulted in year-end net assets totaling $3,693,143.

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis
For Year Ending September 30, 2005

Financial Analysis of the Legal Services Corporation

The financial statements 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 Statement of Net Assets table for FY 2005, the difference between total assets and total liabilities is $3,973,697, which compares to $3,693,143 in FY 2004. Results of operations for September 30, 2005 show a fund balance of $3,277,824; this compares to $2,948,353 as of September 30, 2004. Net investment in capital assets in FY 2005 and FY 2004 total $695,873 and 744,790, respectively.

Table 1
Statement of Net Assets

	September 30	
	2005	2004
Total Current Assets and Other Assets	$ 62,486,643	$ 65,177,107
Net Property and Equipment	695,873	744,790
Total Assets	$ 63,182,516	$ 65,921,897
Grants and Contracts Payable	$ 56,863,552	$ 57,536,172
Other Liabilities	1,073,232	1,296,057
Deferred Revenue	1,272,035	3,396,525
Total Current Liabilities	59,208,819	62,228,754
Net Assets		
Restricted Fund Balances	3,277,824	2,948,353
Investment in capital assets	695,873	744,790
Total Net Assets	3,973,697	3,693,143
Total Liabilities and Net Assets	$ 63,182,516	$ 65,921,897

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis
For Year Ending September 30, 2005

Table 2 presents a comparison of 2005 and 2004 revenues. In 2005, Congressional appropriations, a grant from the U.S. Court of Veterans Appeals, and other revenues totaled $334,226,622. Expenditures for program activities and support activities totaled $333,946,068. In 2004 revenues totaled $336,396,638; expenditures for program activities and support activities were $337,177,773. Table 2 provides a review of each year's operating results.

Table 2
Change in Net Assets

	Years ended September 30, 2005	2004
Revenue		
Federal appropriations	$ 330,803,705	$ 335,282,450
Grant revenue	1,106,803	1,181,030
General revenues		
Change in deferred revenue	2,117,687	(126,346)
Interest and other income	198,427	59,504
Total revenue	334,226,622	336,396,638
Expenses		
Program activities	318,780,977	321,531,556
Supporting activities	15,165,091	15,646,217
Total expenses	333,946,068	337,177,773
Change in net assets	280,554	(781,135)
Net assets, beginning of year	3,693,143	4,474,278
Net assets, end of year	$ 3,973,697	$ 3,693,143

Declines in Federal appropriations and the grant revenues from the U.S. Court of Veterans Appeals were based upon Federal budget considerations, not a decline in the needs for legal services. The Board of Directors of LSC continues to seek increases in funding from Congress to provide adequate funding for legal services programs.

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis
For Year Ending September 30, 2005

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

	2005	2004
Furniture and equipment	$ 431,020	$ 517,768
Software	106,091	59,001
Leasehold improvements	158,762	168,021
Total capital assets (net)	$ 695,873	$ 744,790

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. The largest portion of the LSC budget is mandated by Congress to be distributed to support legal services throughout the country. LSC funds 140 grantees in the 50 states, the District of Columbia, Puerto Rico, Virgin Islands, Guam, and American Samoa.

The Board of Directors adopted a statement of Strategic Directions in 2000 to guide the work of the Corporation from 2000 to 2005. That document will be updated in early 2006. To advance these Strategic Directions, LSC uses competitive grant processes for basic grants and for Technology Initiative Grants, a set of grant assurances and program letters, regular program visits, training and technical assistance visits, and monitoring for compliance to help grantees fulfill the Corporation's mission.

With respect to LSC administration, the budget process maximizes the use of the available funds for this purpose. Office Directors review their offices' monthly activities and expenditures, and at the end of each quarter, a formal review is completed that includes a projection of future fiscal year expenditures. The Treasurer/Comptroller, the Chief Administrative Officer, and the President evaluate this information and make necessary adjustments to ensure that the plans and spending are in accordance with the Strategic Directions.

The LSC Appropriation provides a separate budget line for the Office of Inspector General (OIG). The OIG has two principal missions pursuant to the Inspector General Act: to assist management in identifying ways to promote efficiency and effectiveness in the activities and operations of LSC and its grantees; and to prevent and detect fraud waste and abuse. Additionally, Congress gave the LSC OIG responsibility for overseeing the monitoring of annual audits of grantees by independent public accountants. Finally, the OIG conducts on-site reviews of grantees as appropriate. To accomplish its mission the OIG has created its own multi-year Strategic Plan and an annual work plan. The IG provides the OIG budget information to the Treasurer/Comptroller that is similar to that provided for the LSC management and administration budget, and the OIG follows the same review schedule for activities, expenditures, projections and budgetary adjustments.

The Treasurer/Comptroller prepares a combined report and presents it to the LSC Board of Directors with the President's and the Inspector General's recommended adjustments. This combined presentation affords the Board an opportunity to review and compare each office's budget, actual expenditures and operating projections to establish revised priorities or reaffirm policy directions to advance the Strategic Directions.

Activities for 2005 included the competition process for awarding grants and the associated capability assessments through the Office of Program Performance (OPP). Program visits were made to assess quality; provide technical assistance; review progress in achieving a comprehensive delivery system in reconfigured service areas; evaluate innovative procedures which may serve as models for other programs; and communicate LSC's expectations directly to grantees. These visits expand LSC's understanding of programs' activities otherwise obtained from competition applications, grant activity reports, and anecdotal information. They also enable LSC to provide technical assistance to help programs enhance the quality of services delivered to clients and promote efficiency and effectiveness in delivery systems. When best practices are identified, they are added to LSC's internet library of best practices, and the legal services community is encouraged to replicate them when appropriate.

In 2005, LSC implemented the Leadership Mentoring Pilot Program, an initiative of the Board of Directors. The program seeks to demonstrate a means of addressing the growing need to develop a future corps of diverse leaders in the legal services community. The program includes 18 months of mentoring relationships and leadership training. The goals of the program are to help LSC gather information needed to develop a model leadership mentoring program that may be used by grantees; to identify core competencies required to be an effective leader in a legal services program; and to identify challenges to developing diverse leadership and strategies for overcoming those challenges. LSC will conduct ongoing evaluations of the program.

Also, LSC implemented the pilot Loan Repayment Assistance Program (LRAP) in 2005. The burden of law school debt, which now averages $80,000 per new law school graduate, prevents many recent graduates from considering a career in legal services, where the average starting salary nationally is $37,000 a year. LSC's FY 2005 appropriation contained a provision "to allow LSC to spend up to $1,000,000 from a carryover fund balance for a law school student loan repayment pilot program in FY 2005." LSC will provide loans of up to $5,000 per year for a three year period to sixty-seven attorneys who are working or being recruited to work in fifteen selected programs. The $1,000,000 is included in the Reserved Fund Balance. The selection of participants will occur in FY 2006, and one third of the funds will be expended in each of the next three years. LSC will be evaluating the pilot program to see what impact it has on recruitment and retention of attorneys in LSC-funded programs.

The provision of disaster relief assistance to grantees became a high priority for LSC in September 2005 as a result of Hurricane Katrina. LSC began assisting programs directly affected by the hurricane as well as planning for a significant increase in the need for legal assistance in many states as a result of the storms and the evacuations. LSC established in collaboration with the American Bar Association, the National Legal Aid and Defender Association, Pro Bono Net, a special website to provide disaster relief information to those affected by the hurricane, to advocates assisting them, and to those who wished to volunteer.

With respect to compliance activities, visits to LSC grantees are made by our Office of Compliance and Enforcement (OCE) staff. Some of these visits are made for the purpose of assessing general compliance with LSC rules and regulations and Case Service Reports/Case Management System reviews. Other visits are conducted to investigate complaints; to follow up referrals from the A-50 audit findings and recommendations from the Office of Inspector General (OIG); technical assistance reviews; and training.

In 2005 LSC launched a pilot program of joint visits of OCE and OPP staff to coordinate more effectively the work of the offices and to provide a more comprehensive review of the visited programs. LSC staff developed a new protocol for on-site examination of program quality and compliance, case management reporting, and case management system issues. The purposes of the new visit protocol are 1) to minimize the number of visits to LSC grantees through a more efficient process; 2) to bring to bear the perspectives and experiences of both offices in the performance of LSC's core functions in evaluating compliance and quality; and 3) to identify and incorporate new areas of inquiry that represent an indication of quality in legal services delivery. The pilot project will continue in FY 2006.

LSC completed a major report at the end of the fiscal year, *Documenting the Justice Gap in America: The Current Unmet Civil Legal Needs of Low-Income Americans*. The report concludes that there is a significant shortage of civil legal assistance available to low-income Americans. The LSC "Unable to Serve" study, the first comprehensive national statistical study ever undertaken of the number of clients who seek services from legal services programs and one of the methodologies contained in the report, established that for every client who receives service, one applicant was turned away. The study underestimated the actual unmet need, because it is known that many people do not contact programs either because they do not know they have legal problems, or they do not know that LSC grantees can help them. The justice gap identified in the report -- i.e., the disparity between the civil legal needs of low-income people and the legal help they receive -- is significant and large. LSC-funded programs were only able to assist fifty percent of the people with eligible cases who applied for assistance. Other legal needs surveys indicated that an even larger percentage of low income persons (i.e., 80%) do not obtain assistance, either because it is not available to them, they do not know that they can ask for it, or they do not know where to ask for it.

Table 4 presents a comparison of the original and final revised operating budget for the FY 2005 Management and Administration (M&A) account.

Table 4
Management and Administration
Original and Revised FY 2005 Operating Budget

Budget Category	Original Budget	Final Budget	Variance
Compensation and benefits	$ 9,400,750	$ 9,313,900	$ (86,850)
Temporary employee pay	233,750	221,600	(12,150)
Consulting	871,225	1,032,975	161,750
Travel and transportation expenses	953,145	935,845	(17,300)
Communications	184,201	188,901	4,700
Occupancy cost	1,737,600	1,735,900	(1,700)
Printing and reproduction	152,475	155,275	2,800
Other operating expenses	648,478	597,228	(51,250)
Capital expenditures	275,000	275,000	0
Total	$ 14,456,624	$ 14,456,624	$ 0

As a result of the quarterly expenditure reviews and quarterly budget projections based on changing priorities, internal budgetary adjustments were made. Funds in the amount of $161,750 were needed for the consulting category to pay for higher-than-expected outside legal counsel bills. Other smaller amounts were needed for the communications and printing and reproduction category. These funds were available through savings in other budget categories.

Management's Discussion and Analysis
For Year Ending September 30, 2005

FY 2005 OIG Budgetary Analysis and Activity Description

The FY 2005 OIG budget funded projects reviewing both LSC grantee and internal LSC management operations and activities. Externally focused projects included the review of grantee audit reports and referrals of significant findings to LSC management for resolution, revised grantee audit guidance, audit service reviews of grantee independent public accountants work, audits of the private attorney involvement program and investigations related to theft or embezzlements of grantee funds. Funded projects with an internal focus included the *Report of the Financial Implications of the 3333 K Street Lease*, *Audit of LSC's Two Million Dollar ($2,000,000) Landlord Contribution*, *Audit of LSC's Office Space Needs*, *Audit of LSC Board member travel*, *Review of Compressed Work Schedule and Compensatory Time Practices*, *Review of the Office of Enforcement and Compliance*, the FY 2004 LSC Corporate audit, comments on significant LSC regulatory and policy initiatives, and the second phase of the evaluation of legal services mapping to support the effective delivery of legal services.

The OIG budget presentation in Table 5 presents a comparison of the original and final operating budget for FY 2005. During the year, only a few small reallocations of monies across the budget categories took place in order to increase funding for temporary employees and capital expenditures to upgrade computing equipment.

Table 5
Office of Inspector General
Original and Revised FY 2005 Operating Budget

Budget Category	Original Budget	Final Budget	Increase (Decrease)
Compensation and benefits	$ 2,000,500	$ 1,988,500	$ (12,000)
Temporary employee pay	123,350	156,350	33,000
Consulting	427,699	390,699	(37,000)
Travel and transportation	93,000	91,000	(2,000)
Communications	15,300	17,300	2,000
Occupancy cost	1,000	1,000	0
Printing and reproduction	2,700	2,700	0
Other operating expenses	24,100	24,100	0
Capital expenditures	52,000	68,000	16,000
TOTAL	$ 2,739,649	$ 2,739,649	$ 0

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis
For Year Ending September 30, 2005

Table 6 presents the final M&A budget and expenditures for FY 2005, as well as the budget category variances. A restructuring created the new officer positions of Chief Administrative Officer and Vice President for Programs and Compliance. These positions were filled in May and June, respectively. Another senior manager, the Director of the Office of Governmental Relations and Public Affairs (GRPA), was filled in January. Because of these and other open positions, almost half of the total variance is attributable to savings in personnel compensation and benefits.

Table 6
Management and Administration
Operating Budget versus Actual Expenditures

Budget Category	Final Budget	Expenditures	Variance
Compensation and benefits	$ 9,313,900	$ 8,463,589	$ 850,311
Temporary employee pay	221,600	198,328	23,272
Consulting	1,032,975	767,465	265,510
Travel and transportation	935,845	592,640	343,205
Communications	188,901	140,388	48,513
Occupancy cost	1,735,900	1,707,535	28,365
Printing and reproduction	155,275	126,491	28,784
Other operating expenses	597,228	511,405	85,823
Capital expenditures	275,000	195,507	79,493
TOTAL	$ 14,456,624	12,703,348	1,753,276
Depreciation and amortization		276,303	(276,303)
Loss on disposal of assets		4,916	(4,916)
Less: capitalized assets		(185,708)	185,708
		$ 12,798,859	$ 1,657,765

LEGAL SERVICES CORPORATION

Management's Discussion and Analysis
For Year Ending September 30, 2005

As seen in Table 7, the OIG generated cost savings in the compensation and benefits, consulting, and to a lesser extent in the temporary employee and travel budget categories. These balances resulted from not being able to fill budgeted staff positions and from planned consulting activities that were not completed by the fiscal year close, decreased in scope and cost, or were postponed to next fiscal year. Additionally, the OIG focused on reviewing more internal LSC activities than expected, so travel funds were saved.

Table 7
Office of Inspector General
Operating Budget versus Actual Expenditures

Budget Category	Final Budget	Expenditures	Variance
Compensation and benefits	$ 1,988,500	$ 1,930,587	$ 57,913
Temporary employee pay	156,350	118,634	37,716
Consulting	390,699	235,593	155,106
Travel and transportation	91,000	51,344	39,656
Communications	17,300	14,148	3,152
Occupancy cost	1,000	0	1,000
Printing and reproduction	2,700	2,004	696
Other operating expenses	24,100	13,920	10,180
Capital expenditures	68,000	46,594	21,406
Total	$ 2,739,649	2,412,824	326,825
Depreciation and amortization		0	0
Loss on disposal of assets		0	0
Less: capitalized assets		(46,594)	46,594
		$ 2,366,230	$ 373,419

Table 8 provides the same budget, expenditure, and variance information for Basic Field Programs, U.S. Court of Veterans Appeals Funds, Grants from Other Funds and Technology Initiatives. The unexpended balances from Basic Field, U.S. Court of Veterans Appeals, and Technology Initiatives are combined in the financial statements in Part 2 and are shown as deferred revenue. The unexpended Basic Field Program funds were originally earmarked for the close-out audits of two grantees. Unexpended U.S. Court of Veterans Appeals funds are to be used to support next year's grant. The unexpended Technology Initiative funds are to be awarded early in FY 2006. Because the projects are restricted by legislation, they are considered unearned until the projects are completed.

The Grants from Other Funds are derived from grant recoveries and have been earmarked by the Board of Directors for special and/or emergency program needs. In FY 2005 grants from these funds were made to Community Legal Services of Mid-Florida, Legal Services of North Florida, Southeast Louisiana Legal Services, and Mississippi Center for Legal Services. Because of the Board's earmarking, the variance is included in the restricted net assets total on the balance sheet.

Table 8
Program Budget Versus Actual

	Budget	Expenditures	Variances
Basic Field Programs	$ 315,368,286	$ 315,343,286	$ 25,000
U.S. Court of Veterans Appeals Funds	1,144,492	1,106,803	37,689
Grants From Other Funds	415,422	259,450	155,972
Technology Initiatives	3,422,456	2,213,111	1,209,345
Totals	$ 320,350,656	$ 318,922,650	$ 1,428,006

For budgeting purposes and full reporting to LSC's Board of Directors and the public, there is a slight reporting difference between the interim financial reports and the annual financial statement. The program budget versus expenditures shown above reports grant expenditures of $318,922,650 and the Changes in Net Assets (Table 2 of this Management Discussion and Analysis) and the Statement of Activities reports grant expenditures of $318,780,977. The difference, $141,673, is the amount of FY 2005 grant recoveries and is shown during the year as revenue collected outside of the appropriation process. This reporting provides the Board with an opportunity to revise the budget to include the funds in the budget line for Grants from Other Funds and provide emergency grants from that line. However, when the annual financial statements are completed, the total grant recoveries are used to offset grant expenditures in the Statement of Activities. The detail of this reporting is shown in the financial statements, Note E – Grant and Contracts Expense.

Future Events

LSC recognizes the importance of and will continue to monitor its grantees for compliance with Federal laws and LSC regulations. LSC will continue to work on important initiatives to support its grantees and to improve the quality and accessibility of legal services for the low income individuals, including the use of technology to promote and facilitate access to civil legal services. The detailed goals, objectives and strategies which LSC will pursue will be enumerated in the updated Strategic Directions 2006-2010 document and is scheduled to be adopted by the Board of Directors in early 2006.

The OIG will perform audit, evaluation and investigative activities in accord with the IG Act and the LSC appropriation. In addition to carrying out its Congressionally assigned responsibility to oversee the independent public accountant's reviews and conduct its own reviews of grantees, the OIG will continue reviewing headquarters operations to evaluate the effectiveness and efficiency of LSC in carrying out its mission.

LSC has focused its resources for FY 2006 to continue to advance these efforts. This year's appropriation is $326,577,984. With this new funding and other funds from the FY 2005 carryover, which includes restricted and unrestricted net assets and deferred revenue, projected FY 2006 income from interest and a grant from the U.S. Court of Veterans Appeals, LSC will have $332,702,240 available to carry out its mandate for FY 2006.

Basic Financial Statements

LEGAL SERVICES CORPORATION
STATEMENT OF NET ASSETS AND GOVERNMENTAL FUND BALANCE SHEET
September 30, 2005

	General Fund	Adjustments (Note A)	Statement of Net Assets
ASSETS			
Cash and cash equivalents	$ 62,266,548	$	$ 62,266,548
Accounts Receivable	2,825		2,825
Prepaid expenses and deposits	217,270		217,270
Capital assets (net)		695,873	695,873
Total Assets	$ 62,486,643	$ 695,873	$ 63,182,516
LIABILITIES			
Grants and contracts payable	$ 56,863,552	$	$ 56,863,552
Accounts payable	370,554		370,554
Accrued vacation and other liabilities	702,678		702,678
Deferred Revenue	1,272,035		1,272,035
Total Liabilities	59,208,819		59,208,819
FUND BALANCES / NET ASSETS			
Fund balances:			
Reserved	1,129,367		
Unreserved	2,148,457		
Total fund balances	3,277,824		
Total liabilities and fund balances	$ 62,486,643		
Net assets:			
Invested in capital assets, net of related debt		695,873	695,873
Restricted		3,277,824	3,277,824
Total Net Assets		$ 3,973,697	3,973,697
TOTAL LIABILITIES AND NET ASSETS			$ 63,182,516

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	$ 3,277,824
Capital assets used in governmental activities are not financial resources, and, therefore, are not reported in the fund financial statements	695,873
Total net assets	$ 3,973,697

See accompanying notes and Independent Auditors' Report.

LEGAL SERVICES CORPORATION
STATEMENT OF NET ASSETS AND GOVERNMENTAL FUND BALANCE SHEET
September 30, 2004

	General Fund	Adjustments (Note A)	Statement of Net Assets
ASSETS			
Cash and cash equivalents	$ 65,018,956	$	$ 65,018,956
Accounts receivable	8,055		8,055
Prepaid expenses and deposits	150,096		150,096
Capital assets (net)		744,790	744,790
Total assets	$ 65,177,107	$ 744,790	$ 65,921,897
LIABILITIES			
Grants and contracts payable	$ 57,536,172	$	$ 57,536,172
Accounts payable	439,418		439,418
Accrued vacation and other liabilties	856,639		856,639
Deferred revenue	3,396,525		3,396,525
Total liabilities	62,228,754		62,228,754
FUND BALANCE/NET ASSETS			
Fund balances:			
Reserved	358,002		
Unreserved	2,590,351		
Total fund balances	2,948,353		
Total liabilities and fund balances	$ 65,177,107		
Net assets:			
Invested in capital assets, net of related debt		744,790	744,790
Restricted		2,948,353	2,948,353
Total net assets		$ 3,693,143	3,693,143
TOTAL LIABILITIES AND NET ASSETS			$ 65,921,897

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	$ 2,948,353
Capital assets used in governmental activities are not financial resources, and, therefore, are not reported in the fund financial statements	744,790
Total net assets	$ 3,693,143

See accompanying notes and Independent Auditors' Report.

LEGAL SERVICES CORPORATION
STATEMENT OF ACTIVITIES AND GOVERNMENTAL FUND REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
Year ended September 30, 2005

	General Fund	Adjustments (Note A)	Statement of Activities
EXPENDITURES/EXPENSES			
Grants	$ 318,780,977	$ -	$ 318,780,977
Board of Directors	260,380	-	260,380
Executive Office	641,936	-	641,936
Legal Affairs	1,068,673	-	1,068,673
Governmental Relations and Public Affairs	581,079	-	581,079
Human Resources	470,971	-	470,971
Financial and Administrative Services	2,876,832	(18,369)	2,858,463
Information Technology	985,818	(162,423)	823,395
Program Performance	2,725,109	-	2,725,109
Information Management	820,128	-	820,128
Compliance and Enforcement	2,213,278	-	2,213,278
Office of Inspector General	2,412,825	(46,594)	2,366,231
30th Anniversary	59,145	-	59,145
Depreciation/amortization		276,303	276,303
Total expenditures/expenses	333,897,151	48,917	333,946,068
PROGRAM REVENUES			
Federal Appropriations	330,803,705		330,803,705
U.S. Court of Veterans Appeals Funds	1,106,803		1,106,803
Change in deferred revenue	2,117,687		2,117,687
Total program revenues	334,028,195	-	334,028,195
GENERAL REVENUES			
Interest and other income	198,427		198,427
Total general revenues	198,427	-	198,427
Excess of revenues over expenses	329,471	(329,471)	-
Change in net assets		280,554	280,554
Fund Balance/net assets:			
Beginning of the year	2,948,353		2,948,353
Invested in capital assets, net		744,790	744,790
Net Assets, End of the year	$ 3,277,824	$ 695,873	$ 3,973,697

See accompanying notes and Independent Auditors' Report.

LEGAL SERVICES CORPORATION
STATEMENT OF ACTIVITIES AND GOVERNMENTAL FUND REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
Year ended September 30, 2005

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				$	329,471
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.					(48,917)
Change in net assets				$	280,554
	Fund balance:				
	Beginning of year	$	2,948,353		
	Net change		329,471		
	End of year		3,277,824	$	3,277,824
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		(329,471)		
	Change in net assets		280,554		
	Capital assets, beginning		744,790		
	Capital assets (net)	$	695,873		695,873
Total net assets				$	3,973,697

See accompanying notes and Independent Auditors' Report.

LEGAL SERVICES CORPORATION
STATEMENT OF ACTIVITIES AND GOVERNMENTAL FUND REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
Year ended September 30, 2004

	General Fund	Adjustments (Note A)	Statement of Activities
EXPENDITURES / EXPENSES			
Grants	$ 321,531,556	$	$ 321,531,556
Board of Directors	218,126		218,126
Executive Office	471,894		471,894
Legal Affairs	949,908		949,908
Governmental Relations and Public Affairs	596,350		596,350
Human Resources	666,658		666,658
Financial and Administrative Services	2,629,162	(38,763)	2,590,399
Information Technology	1,163,253	(75,087)	1,088,166
Program Performance	2,873,268		2,873,268
Information Management	777,815		777,815
Compliance and Enforcement	2,433,789		2,433,789
Office of Inspector General	2,730,710	(33,698)	2,697,012
Depreciation / amortization		282,832	282,832
Total expenditures/expenses	337,042,489	135,284	337,177,773
PROGRAM REVENUES			
Federal Appropriation	335,282,450		335,282,450
U.S. Court of Veterans Appeals Funds	1,181,030		1,181,030
Change in deferred revenue	(126,346)		(126,346)
Total program revenues	336,337,134		336,337,134
GENERAL REVENUES			
Interest and other income	59,504		59,504
Total general revenues	59,504		59,504
Excess of revenues over expenditures	(645,851)	645,851	
Change in net assets		(781,135)	(781,135)
Fund balance/net assets:			
Beginning of the year	3,594,204		3,594,204
Invested in capital assets, net		880,074	880,074
End of the year	$ 2,948,353	$ 744,790	$ 3,693,143

See accompanying notes and Independent Auditors' Report.

LEGAL SERVICES CORPORATION
STATEMENT OF ACTIVITIES AND GOVERNMENTAL FUND REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
Year ended September 30, 2004

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				$	(645,851)
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.					(135,284)
Change in net assets				$	(781,135)
	Fund balance:				
	Beginning of year	$	3,594,204		
	Net change		(645,851)		
	End of year		2,948,353	$	2,948,353
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		645,851		
	Change in net assets		(781,135)		
	Capital assets, beginning		880,074		
	Capital assets (net)	$	744,790		744,790
Total net assets				$	3,693,143

See accompanying notes and Independent Auditors' Report.

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2005 and 2004

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

1. *Change in Reporting Entity:* Legal Services Corporation ("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.

In prior year financial statements, Friends of the Legal Services Corporation ("FoLSC"), a District of Columbia nonprofit corporation, was reported in the disclosure notes as a discretely presented component unit as defined by the Governmental Accounting Standards Board (GASB). This disclosure was necessary because the significance of their operating and financial relationship with LSC was such that exclusion would cause LSC's financial statements to be misleading or incomplete. In FY 2005, due to a change in FoLSC management, FoLSC no longer meets the criteria for reporting as a discrete component unit of LSC.

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.

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 Balance (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.

Note A - Summary of Significant Accounting Policies (Continued)

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. *Cash and Cash Equivalents*: LSC's cash and cash equivalents includes a fund balance with U.S. Treasury of $33,345,058 and $34,787,820 at September 30, 2005 and 2004, respectively.

5. *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. Depreciation is reported as an unallocated expense and is not directly identified with individual functions.

6. *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.

7. *Revenues*: The Federal appropriations are reported as program revenue in the period expended. The appropriation remains available until expended and unexpended grant funds are shown as deferred revenue.

8. *Fund Balance / Net Assets:* The Board of Directors, through its fund allocation process, has designated $1,129,367 and $358,002 of the fund balance for continuing programs and administrative activities as of September 30, 2005, and 2004, respectively. Net assets are reported as restricted due to constraints imposed for their use by Congressional appropriation legislation.

9. *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 may 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.

10. *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.

11. *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.

12. *Concentration of Revenue*: LSC receives substantially all of its revenue from direct Federal government appropriations.

***NOTE B – CONCENTRATION OF CREDIT RISK*:**

LSC invests cash balances in excess of predefined target balances through repurchase agreements with two financial institutions. The following categories of credit risk disclose the level of custody credit risk assumed by LSC based upon how its deposits were insured or secured with collateral at September 30, 2005 and 2004:

Category 1 – Insured by FDIC.

Category 2 – Uninsured but collateralized with securities held by the pledging financial institution's trust department in LSC's name.

Category 3 – Uninsured and uncollateralized.

		Custody Credit Risk Category			
September 30	Total bank balance	1	2	3	Total Carrying Value
2005	$ 29,104,831	$ 195,000	$ 16,931,000	$ 11,978,831	$ 28,919,490
2004	$ 30,688,137	$ 196,720	$ 18,397,000	$ 12,094,417	$ 30,229,135

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2005 and 2004

NOTE C - EQUIPMENT:

Property and equipment consists of the following at September 30, 2005

	Beginning Balance	Additions	Disposals	Ending Balance
Furniture and equipment	$ 1,654,044	$ 126,203	$ (87,562)	$ 1,692,685
Software	318,739	91,753	(50,462)	360,030
Leasehold improvements	209,587	14,345		223,932
Subtotal	2,182,370	232,301	(138,024)	2,276,647
Less: Accumulated depreciation	1,437,580	276,302	(133,108)	1,580,774
Capital assets (net)	$ 744,790	$ (44,001)	$ (4,916)	$ 695,873

Property and equipment consists of the following at September 30, 2004

	Beginning Balance	Additions	Disposals	Ending Balance
Furniture and equipment	$ 1,656,677	$ 111,335	$ (113,968)	$ 1,654,044
Software	285,726	33,013		318,739
Leasehold improvements	205,637	3,950		209,587
Subtotal	2,148,040	148,298	(113,968)	2,182,370
Less: Accumulated depreciation	1,267,966	282,832	(113,218)	1,437,580
Capital assets (net)	$ 880,074	$ (134,534)	$ (750)	$ 744,790

Depreciation expense for the years ended September 30, 2005 and 2004 are $276,302 and $282,832, respectively.

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 in the amount of $1,100,000 for 2005 and $1,175,000 for 2004. Grant revenues for the years ended September 30, 2005, and 2004, total $1,106,803 and $1,181,030, respectively.

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
September 30, 2005 and 2004

NOTE E - GRANT AND CONTRACTS EXPENSE:

Grant funding provided to the Legal Services Corporation, pursuant to Public Law 108-447, was for basic field programs. Grant and contracts expense for the years ended September 30, 2005 and 2004 consists of the following:

	2005	2004
Basic field programs	$ 315,343,286	$ 315,578,624
U.S. Court of Veterans Appeals fund	1,106,803	1,181,029
Technology Initiatives	2,213,111	3,844,789
Grants from other funds	259,450	1,009,432
Grant recoveries	(141,673)	(82,318)
Totals	$ 318,780,977	$ 321,531,556

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

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

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

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

LSC's contributions to these plans for the years ended September 30, 2005 and 2004 were $674,893 and $633,090 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.

NOTE G – LEASES:

Related Party Lease

On June 1, 2003, LSC commenced an operating lease agreement for new office space with the FoLSC, a nonprofit corporation whose primary purpose is to carryout activities that benefit LSC. Although LSC does not exert control or significant influence over the management or operations of FoLSC, the relationship of the two organizations is such that arms length transactions may not be achieved.

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

		Amount
September 30, 2006	$	1,710,000
2007		1,710,000
2008		1,710,000
2009		1,710,000
2010		1,710,000
Thereafter		4,560,000
Total	$	13,110,000

Rental expense for the years ended September 30, 2005 and 2004 is $1,710,000 each year. No amounts are due to or from FoLSC at September 30, 2005 and 2004.

Sublease
During fiscal year 2005, LSC entered into a five-year sublease to lease a portion of its space, expiring in fiscal year 2010. The lease agreement provides for an annual base rent of $53,475 with a 2% annual increase. The total minimum payments required under this sublease are as follows:

		Amount
September 30, 2006	$	53,609
2007		56,817
2008		57,958
2009		59,088
2010		55,471
Total	$	282,943

Total sublease income in fiscal year 2005 is approximately $6,700 and is reported as a reduction of rental expense in the accompanying financial statements.

NOTE H - CONTINGENCIES:

1. *Grants and Contracts*: LSC receives its funding from appropriations by Congress and grants from the U.S. Court of Veterans Appeals and accordingly, may be subject to Federal audits. In addition, LSC provides significant funding to several independent organizations, which are subject to their own independent audits and audits by LSC. LSC's management does not expect any significant adjustments as a result of Federal audits should they occur or from the audits of the grantees' independent organizations.

2. *Claims*: During 1999, three (one former and two current) employees filed charges with the District of Columbia Office of Human Rights alleging that LSC engaged in discriminatory employment practices. Two of the cases have since been dismissed and one is presently in negotiations. LSC believes it has not violated any laws and that any loss would be immaterial. No amounts have been recorded in the financial statements for these contingent liabilities.

During 2004, three (one former and two current) employees filed a joint action alleging unfair employment practices under the wage and hour laws and requested damages of $1,151,475 plus unspecified costs. Management is vigorously contesting and defending against this suit and filed a counterclaim against one of the plaintiffs in 2004. The cases of two of the plaintiffs were dismissed by the courts in 2005. The remaining case is currently scheduled for court ordered mediation in January 2006. No amounts have been recorded in the financial statements for these contingent liabilities. Management believes a judgment in favor of the remaining plaintiff, if any, would be immaterial.

In January 2005, the former Executive Director of an LSC grantee filed a lawsuit against LSC and certain officers and employees of LSC seeking unspecified actual and punitive damages relating to allegations of defamation and slander and related charges. The case is in the discovery phase with trial scheduled for April 2006. Management is vigorously contesting these allegations and defending against this suit. No amounts have been recorded in the financial statements for these contingent liabilities.

NOTE I – OTHER MATTERS

Certain amounts in the prior year financial statements have been adjusted for comparative purposes to conform to the presentation in the current year.

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

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS 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, 2005 and have issued our report thereon dated December 15, 2005. 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.

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 an opinion 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 that might be material weaknesses. A material weakness is a reportable 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 caused by error or fraud 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.

Compliance and Other Matters: 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 grant agreements, 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 tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain other matters that we reported to management of LSC in a separate letter dated December 15, 2005.

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.

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

December 15, 2005