LEGAL SERVICES CORPORATION
FINANCIAL STATEMENTS
SEPTEMBER 30, 2001 and 2000
Together with Independent Auditor's Report

LEGAL SERVICES CORPORATION

SEPTEMBER 30, 2001 AND 2000

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Acting Inspector General and Board of Directors
Legal Services Corporation

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying balance sheet of Legal Services Corporation (the Corporation) as of September 30, 2001 and the related statements of support, revenue and expenses and changes in fund balance, and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Corporation as of September 30, 2000 were audited by other auditors whose report dated November 23, 2000, expressed an unqualified opinion on those statements.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Corporation as of September 30, 2001 and the results of its operations and changes in its fund balance and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 30, 2001 on our consideration of the Corporation's internal controls over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of the audit.

November 30, 2001
Silver Spring, Maryland

LEGAL SERVICES CORPORATION
BALANCE SHEETS
SEPTEMBER 30, 2001 and 2000

	2001	2000
ASSETS		
Current assets		
Cash and cash equivalents (Note 3)	$63,286,101	$54,512,955
Due from employees	20,420	20,331
Prepaid expenses and deposits	368,659	315,069
Total current assets	63,675,180	54,848,355
Property and equipment	2,369,064	2,289,739
Less accumulated depreciation and amortization	(1,564,486)	(1,198,150)
Net property and equipment	804,578	1,091,589
TOTAL ASSETS	**$64,479,758**	**$55,939,944**
LIABILITIES AND FUND BALANCE		
Current liabilities		
Grants and contracts payable	$56,192,751	$50,823,681
Accounts payable	450,034	489,482
Accrued vacation and other liabilities	570,045	611,375
Deferred rent credit - current portion (Note 10)	126,692	190,039
Deferred revenue	4,941,337	1,599,831
Total current liabilities	62,280,859	53,714,408
Deferred rent credit - non-current portion (Note 10)	-0-	126,692
Total liabilities	62,280,859	53,841,100
Fund balance		
Federal appropriations (Notes 2 and 8)		
Designated	140,881	153,767
Undesignated	1,253,440	853,488
Net investment in property and equipment	804,578	1,091,589
Total fund balance	2,198,899	2,098,844
TOTAL LIABILITIES AND FUND BALANCE	**$64,479,758**	**$55,939,944**

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

LEGAL SERVICES CORPORATION
STATEMENTS OF SUPPORT, REVENUE AND EXPENSES
AND CHANGES IN FUND BALANCE
YEARS ENDED SEPTEMBER 30, 2001 AND 2000

	2001	2000
SUPPORT AND REVENUE		
Federal appropriations	$329,274,000	$303,841,000
Less: change in deferred revenue	(3,320,200)	(1,553,014)
Grant revenue (Note 5)	873,696	885,991
Interest and other income	298,977	388,520
Total support and revenue	327,126,473	303,562,497
EXPENSES		
Program activities:		
Grant and contracts (Note 6)	313,884,095	292,214,190
Supporting activities:		
Management and administration (Notes 7)	13,142,323	11,756,029
Total expenses	327,026,418	303,970,219
Excess (deficit) of support and revenue over (under) expenses	100,055	(407,722)
Fund balance, beginning of year	2,098,844	2,506,566
Fund balance, end of year	$ 2,198,899	$ 2,098,844

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

LEGAL SERVICES CORPORATION
STATEMENTS OF CASH FLOWS
YEARS ENDED SEPTEMBER 30, 2001 AND 2000

	2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES:		
Excess (deficit) of support and revenue (under) over expenses	$ 100,055	$ (407,722)
Adjustments to reconcile excess (deficit) of support and revenue over (under) expenses to net cash provided by (used in) operating activities:		
Depreciation and amortization	526,610	158,200
Loss on disposal of assets	7,309	4,323
(Increase) decrease in accounts receivables	(90)	4,786
(Increase) decrease in prepaid expenses and deposits	(53,590)	11,306
Increase in grants and contracts payables	5,369,070	2,184,228
Decrease in accounts payable	(39,448)	(275,036)
Decrease in accrued vacation and other liabilities	(41,330)	170,316
Decrease in deferred rent credit	(190,039)	(190,039)
Increase (decrease) in deferred revenue	3,341,506	1,577,024
Net cash provided by operating activities	9,020,053	3,237,386
CASH FLOWS USED IN INVESTING ACTIVITIES:		
Purchase of fixed assets	(246,907)	(399,120)
Net increase in cash	8,773,146	2,838,266
Cash and cash equivalents, beginning of year	54,512,955	51,674,689
Cash and cash equivalents, end of year	$ 63,286,101	$ 54,512,955
SUPPLEMENTAL DISCLOSURE OF NON-CASH FLOW INVESTING ACTIVITIES:		
Write-off of fixed assets disposed of with related accumulated depreciation of $135,446 and $14,714, respectively	$ 167,583	$ 19,037

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

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2001 AND 2000

***NOTE 1 - NATURE OF THE CORPORATION*:** The Legal Services Corporation (the Corporation) is a private non-membership District of Columbia nonprofit corporation, established by Congress in the Legal Services Corporation Act of 1974, Public Law 93-355, and amended in 1977 by Public Law 95-222. The purpose of the Corporation is to provide financial support to independent organizations that directly provided legal assistance in non-criminal proceedings or matters to persons financially unable to afford such counsel.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES: The following is a summary of significant accounting policies utilized by the Corporation.

- *Basis of Accounting*: (fund accounting) - The accounts of the Corporation are maintained on the accrual basis of accounting. To ensure observance of limitations and restrictions placed on the use of resources, the accounts are maintained in accordance with the principles of fund accounting whereby resources are classified for accounting and reporting purposes into funds established to their activities and objectives.

  The federal appropriations fund includes amounts received and expended in furtherance of the Corporation's objective, including general operations. The property fund represents investments in property, equipment and computer software, net of accumulated depreciation and amortization. Capital assets purchased or proceeds from their sale are recorded by transfer from or to the federal appropriations fund. Separate accounts are maintained for each fund; however, for reporting purposes they are combined in the accompanying financial statements.

  Federal appropriations fund balances have been stated as either designated or undesignated. Designated fund balances represent amounts that have been earmarked by the Board of Directors for continuing programs and administrative activities. Undesignated fund balances represent appropriated federal carryover and other operating excess, which are available for future use at the discretion of the Board of Directors.

- *Estimates*: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results may differ from those estimates.

- *Support and Revenue*: The federal appropriations are reported as support and revenue in the period expended. The appropriation remains available until expended.

- *Grant Refunds***:** Grantees who have not complied with the requirements of the Legal Services Corporation Act of 1974 and implementing regulations may be subject to actions that result in a recovery of grant funds. Sources of grant refunds generally include recoveries of disallowed costs, excess fund balances, unexpended funds on Private Attorney Involvement programs and sanctions imposed by the Corporation for failure to comply with other regulatory requirements.

- *Grants and Contracts to Recipients*: Liabilities, expenses and revenues related to grant and contract awards are recognized when the awarding document is fully executed. Grant awards are made to recipients on a calendar year basis from appropriations received by the Corporation for its fiscal year.

- *Property and Equipment*: Property and equipment are stated at cost and depreciated using the straight-line method over the estimated useful lives of the assets of five to ten years.

- *Income Taxes*: The Corporation is exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code and the applicable income tax regulations of the District of Columbia, except for unrelated business income. The Corporation had no unrelated business income for 2001 and 2000, and accordingly, no provision for income taxes has been made in the accompanying financial statements.

- *Concentration of Revenue*: The corporation receives substantially all of its revenue from a direct federal appropriation.

- *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.

- *GASB No. 34 - Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*: In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34 - *Basic Financial Statements and Management's Discussion and Analysis - for State and Local Governments*. This statement is effective for governments with revenues of $100 million or more for periods beginning after June 15, 2001. Therefore, the Corporation plans to adopt this statement beginning with its FY 2002 financial statements. The primary effect of this statement is to modify the form of the financial statement presentation and to provide for additional information. The statement requires the restatement of prior periods where adjustments to prior periods are necessary to comply with this statement. If restatement of prior periods is not practical, the cumulative effect of applying this Statement should be reported as a restatement of beginning fund balance.

NOTE 3 - CASH AND CASH EQUIVALENTS: Cash and cash equivalents consist of cash on deposit at financial institutions and undisbursed appropriations which constitute spending authority that remain available in the Corporation's account held by the U.S. Treasury. Cash consists of the following:

LEGAL SERVICES CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2001 AND 2000

	2001	2000
Cash in financial institutions	$ 26,187,479	$ 26,376,846
Cash in U.S. Treasury	37,098,622	28,136,109
Total	$ 63,286,101	$ 54,512,955

NOTE 4 - PROPERTY AND EQUIPMENT: Property and equipment consists of the following at September 30, 2001 and 2000 as follows:

	2001	2000
Furniture and equipment	$1,842,063	$1,793,500
Software	230,881	200,119
Leasehold improvements	296,120	296,120
Subtotal	2,369,064	2,289,739
Less: Accumulated depreciation	(1,564,486)	(1,198,150)
Total	$804,578	$1,091,589

NOTE 5 - GRANT REVENUE: The Corporation was awarded grants from the U.S. Court of Veterans Appeals for the purpose of furnishing legal assistance to veterans. Grant revenue for the years ended September 30, 2001 and 2000 are $ 873,696 and $ 885,991, respectively.

***NOTE 6 - GRANT AND CONTRACTS EXPENSE*:** Grant funding provided to the Legal Services Corporation, pursuant to Public Law 106-553, was for basic field programs. Grant and contracts expense consists of the following:

	2001	2000
Basic field programs	$309,221,790	$288,607,360
U.S. Court of Veterans Appeals fund	873,696	885,991
Technology Initiatives	3,760,609	2,696,986
Grant from other funds	28,000	51,500
Grant refunds/recoveries	-0-	(27,647)
Total	$313,884,095	$292,214,190

NOTE 7 - MANAGEMENT AND ADMINISTRATIVE EXPENSES: Management and administrative expenses consist of the following:

	2001	2000
Personnel compensation	$ 8,297,942	$7,179,855
Temporary employee pay	168,391	186,010
Consulting	1,171,490	1,497,943
Travel and transportation	888,142	826,318
Communications	147,816	133,653
Occupancy cost	1,307,449	1,296,518
Printing and reproduction	99,832	71,767
Other operating expenses	507,102	457,166
Capital expenditures	267,147	343,396
Subtotal	12,855,311	11,992,626
Depreciation and amortization	526,610	158,200
Loss on disposal of assets	7,309	4,323
Purchase of assets	(246,907)	(399,120)
Total	$ 13,142,323	$11,756,029

NOTE 8 - FUND BALANCE: The Board of Directors through its fund allocation process, has designated $140,881 and $153,767 of the federal appropriations fund balance for continuing programs and administrative activities as of September 30, 2001 and 2000, respectively.

NOTE 9 - RETIREMENT PLANS: Pursuant to the Legal Services Corporation Act, all officers and employees hired before October 1, 1988 are participants in the Civil Service Retirements 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). The Corporation 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 the Corporation and by Corporation employees represents the amount which must be financed directly by OPM. The Corporation 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. The Corporation 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.

The Corporation 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 the Corporation's pension and thrift plan, which is a tax deferred annuity plan subject to Section 403(b) of the Internal Revenue Code. Individuals can make contributions up to the maximum permitted by law. Prior to July 1, 1999, the Corporation matched the first 1% contributed by the employee; effective July 1, this percentage was increased to 2.51%. In addition, the Corporation contributes 6% of each eligible employee's salary regardless of their participation to the maximum permitted under federal income tax rules.

The Corporation's contributions to these plans for fiscal years 2001 and 2000 were $540,206 and $454,626, respectively. These amounts are included in supporting activities for management and administration expenses.

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

***NOTE 10 - LEASES*:**

- <u>*Operating Leases*</u>: The Corporation's lease for its headquarters office space provides for increases in annual base rent based on consumer price index increases, and payment of a portion of the building operating expenses. The lease commenced on June 1, 1992 also provided for rent abatement for the first twelve months of the lease term. This deferred rent credit is amortized over the life of the original lease. The lease was amended in November 2001 to extend it through May 2007. Future minimum lease payments required under this lease are as follows:

September 30, 2002	$ 1,031,320
2003	1,433,415
2004	1,462,824
2005	1,492,767
2006	1,523,379
2007 and thereafter	1,029,310
Total	$ 7,973,015

Note10 - Leases (Continued)

The Corporation has termination rights under the lease at any time after May 2003 if certain conditions are met, and providing nine months notice.

Total minimum future payments have not been reduced by $137,584 of sublease rentals to be received in the future under a non-cancelable sublease.

	2001	**2000**
Gross rental expense	$1,330,265	$1,310,391
Adjustment for rent deposit	(250)	-0-
Deferred rent expense	(190,039)	(190,039)
Sublease income	(203,839)	(200,827)
Net rent expense	$ 936,137	$ 919,525

- *Subleases*: The Corporation's sublease of its headquarters office space provides for increases in annual base rent of 1.5%, and payment of any excess operating expenses or real estate taxes. The lease commenced on June 3, 1996 and expires in May 2002. Future minimum rentals as of September 30, 2001 are $120,000.

NOTE 11 - CONTINGENCIES:

- *Grants and Contracts*: The Corporation receives its funding from appropriations by Congress and grants from federal agencies and, accordingly, may be subjected to audits from the respective agencies. In addition, the Corporation provides significant funding to several independent organizations, which are subjected to their own independent audits and audits by the Corporation.

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

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

Acting Inspector General and Board of Directors
Legal Services Corporation

REPORT ON COMPLIANCE AND ON 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 (the Corporation) as of and for the year ended September 30, 2001, and have issued our report thereon dated November 30, 2001. 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 the Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such opinion. The results of our test disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

Internal Control Over Financial Reporting: In planning and performing our audit, we considered the Corporation's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting, which we have reported to management of the Corporation in a separate letter dated November 30, 2001.

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.

November 30, 2001
Silver Spring, Maryland