

# Financials

Financial Statements and Independent Auditor's Report For The Year Ended September 30, 2011



WithumSmith+Brown  
A Professional Corporation  
Certified Public Accountants and Consultants

8403 Colesville Road, Suite 340  
Silver Spring, Maryland 20910-6331 USA  
301 585 7990 . fax 301585 7975  
www.withum.com

Additional Offices in New Jersey  
New York and Pennsylvania

### Independent Auditors' Report

To Inspector General and Board of Directors,  
Legal Services Corporation:

We have audited the accompanying statement of financial position of Legal Services Corporation ("LSC") as of September 30, 2011, and the related statements of activities and change in net assets, and cash flows for the year then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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 the 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 LSC as of September 30, 2011, and the changes in its net assets and its 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 January 9, 2012, on our consideration of LSC's internal control 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 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 considered in assessing the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements as a whole. The accompanying Management's Discussion and Analysis is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

A handwritten signature in blue ink that reads "WithumSmith+Brown, PC".

Silver Spring, Maryland  
January 9, 2012

# Financial Statements

## Statement of Financial Position

September 30, 2011

### ASSETS

#### Current Assets

Cash and cash equivalents	\$ 80,128,158
Accounts receivable, net	16,473
Prepaid expenses and deposits	174,875

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Total current assets	80,319,506
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Property and equipment, net	\$ 754,240
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	\$ 81,073,746
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### LIABILITIES and NET ASSETS

#### Current Liabilities

Grants and contracts payable	\$ 64,187,855
Accounts payable	968,328
Accrued vacation and other liabilities	1,225,290
Deferred revenue	6,674,663

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Total Current Liabilities	73,056,136
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### NET ASSETS

#### Unrestricted

Undesignated	6,395,222
Board designated	855,648
Net investment in fixed assets	754,240

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Total unrestricted	8,005,110
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Temporarily restricted	12,500
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Total net assets	8,017,610
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	\$ 81,073,746
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The Notes to Financial Statements are an integral part of these statements.

# Financial Statements *(cont.)*

## Statement of Activities and Change in Net Assets

Year Ended September 30, 2011

<b>SUPPORT and REVENUES</b>	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Total</b>
Federal appropriations	\$ 404,190,000	\$ -	\$ 404,190,000
Grant revenue	2,315,360		2,315,360
Interest	1,561		1,561
Other income	12,019	12,500	24,519
Donated Services	67,145		67,145
Change in deferred revenue	(718,856)		( 718,856)
<b>Total Revenue</b>	<b>405,867,229</b>	<b>12,500</b>	<b>405,879,729</b>
<b>EXPENSES</b>			
Program services			
Grants, contracts and reimbursable expenses	383,027,214		383,027,214
Herbert S. Garten Loan Repayment Assistance Program	1,517,646		1,517,646
Supporting services			
Management and grants oversight	16,907,199		16,907,199
Office of Inspector General	4,038,712		4,038,712
<b>Total expenses</b>	<b>405,490,771</b>		<b>405,490,771</b>
Change in net assets	376,458	12,500	388,958
Net assets, beginning of year	7,628,652		7,628,652
Net assets, end of year	\$ 8,005,110	\$ 12,500	\$ 8,017,610

The Notes to Financial Statements are an integral part of these statements.

# Financial Statements (cont.)

## Statement of Cash Flows

Year Ended September 30, 2011

### CASH FLOWS FROM OPERATING ACTIVITIES

Change in net assets	\$ 388,958
Adjustments to reconcile change in net assets to net cash and cash equivalents provided by operating activities:	
Depreciation and amortization	225,917
Loss on disposal of assets	268
Changes in assets and liabilities:	
Accounts receivable	303
Prepaid expenses and deposits	205,669
Grants and contracts payable	(5,243,455)
Accounts payable	610,019
Accrued vacation and other liabilities	213,641
Deferred revenue	718,856
Net cash used by operations	(2,879,824)

### CASH FLOWS FROM INVESTING ACTIVITIES

Purchase of property and equipment	(588,429)
Net cash used by investing activities	(588,429)
Net decrease in cash and cash equivalents	(3,468,253)

### CASH AND CASH EQUIVALENTS

Beginning of year	83,596,411
End of year	\$ 80,128,158

### SUPPLEMENTAL INFORMATION

Income taxes paid	\$	0
Interest paid	\$	0

The Notes to Financial Statements are an integral part of these statements.

## **NOTE 1 ORGANIZATION AND PURPOSE**

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.

## **NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

### **Basis of Accounting**

LSC’s financial statements are prepared on the accrual basis of accounting. Accordingly, revenue is recognized when earned, and expenses are recorded when incurred in accordance with accounting principles generally accepted in the United States of America.

The federal appropriations include amounts received and expended in furtherance of LSC’s objectives.

### **Basis of Presentation**

LSC follows accounting standards established by the Financial Accounting Standards Board (FASB) which is the source of generally accepted accounting principles (GAAP) for not-for-profit entities. The financial statement presentation follows the recommendations of the FASB Accounting Standards Codification (ASC) 958, Not-for-Profit Entities. Under FASB ASC 958, LSC is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted, and permanently restricted.

LSC has recorded transactions in the following net asset categories:

*Unrestricted net assets* – net assets that are not subject to donor imposed restrictions.

*Temporarily restricted net assets* – Net assets subject to donor imposed restrictions that will be met by the passage of time or which will be fulfilled by the actions of LSC.

### **Cash and Cash Equivalents**

LSC’s cash and cash equivalents includes a fund balance with U.S. Treasury of \$44,411,646.

### **Accounts Receivable**

Accounts receivable are net of an allowance of \$1,113,777 at September 30, 2011, determined based on historical experience and an analysis of specific amounts.

### **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.

### **Revenues**

Federal appropriations are reported as support and revenue in the period the public law makes them available. The appropriation remains available until expended. Unexpended appropriated funds are shown as deferred revenue and adjustments are made to the account Change in Deferred Revenue to recognize the annual adjustment.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### **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.

### **Grant Recoveries**

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, as well as other types of recoveries. Grant recoveries are reported as a reduction of grant and contract expenses on the accompanying statement of activities.

### **Net Assets**

Net assets related to federal appropriations have been reported as either designated or undesignated. Designated net assets represent amounts that have been earmarked by the Board of Directors for continuing programs and administrative activities. Undesignated net assets represent appropriated federal carryover and other operating excess, which are available for future use at the discretion of the Board of Directors. Net assets invested in fixed assets represent investments in property, equipment and computer software, net of accumulated depreciation and amortization.

The Board of Directors, through its fund allocation process, has designated \$855,648 of the fund balance for continuing programs and administrative activities as of September 30, 2011. Net assets are reported as restricted due to donor stipulations that limit the use of the donated asset.

### **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.

### **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. No provision for income taxes was required for the year ended September 30, 2011, as LSC had no net unrelated business income.

LSC evaluates its uncertain tax positions using the provisions of FASB ASC 450, Accounting for Contingencies. Accordingly, a loss contingency is recognized when it is probable that a liability has been incurred as of the date of the financial statements and the amount of the loss can be reasonably estimated. The amount recognized is subject to estimates and management judgment with respect to the likely outcome of each uncertain tax position. The amount that is ultimately sustained for an individual uncertain tax position or for all uncertain tax positions in the aggregate could differ from the amount recognized. There were no liabilities for uncertain tax positions as of September 30, 2011. There was also no tax-related to interest and penalties reported in the financial statements.

## NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

LSC's Forms 990, Return of Organization Exempt from Income Tax, for the years ending September 30, 2008, 2009 and 2010 are subject to examination by the IRS, generally for 3 years after they were filed.

### Concentration of Revenue

LSC receives substantially all of its revenue from direct federal government appropriations.

## NOTE 3 CONCENTRATION OF CREDIT RISK – DEPOSITS

At September 30, 2011, LSC funds are in non-interest bearing accounts. LSC's cash accounts are subject to Federal Deposit Insurance Corporation (FDIC) limits. Non-interest bearing accounts are fully insured by the FDIC through December 31, 2012.

## NOTE 4 EQUIPMENT

Property and equipment consists of the following at September 30, 2011:

	<b>Beginning</b>			<b>Ending</b>
	<b>Balance</b>	<b>Additions</b>	<b>Disposals</b>	<b>Balance</b>
Furniture and equipment	\$ 1,939,453	\$ 423,506	\$ (53,008)	\$ 2,309,951
Software	406,050	60,973	-	467,022
Leasehold improvements	351,698	103,949	-	455,647
Subtotal	2,697,201	588,428	(53,008)	3,232,620
Less: Accumulated depreciation /amortization	(2,305,205)	(255,917)	52,741	(2,478,380)
Capital assets (net)	\$ 391,996	\$ 362,511	\$ (267)	\$ 754,240

Depreciation/amortization expense for the year ended September 30, 2011 is \$225,917.

## NOTE 5 GRANT REVENUE

LSC was awarded a grant from the U.S. Court of Veterans Appeals for the purpose of furnishing legal assistance to veterans. Grant revenues for the year ended September 30, 2011, total \$2,315,360.

## NOTE 6 GRANTS AND CONTRACTS EXPENSE

Grants and contracts expense for the year ended September 30, 2011 consists of the following:

	<b>2011</b>
Basic Field Programs	\$ 377,892,573
U.S. Court of Veterans Appeals	2,311,575
Grant From Other Funds	111,409
Technology Initiatives	2,903,326
Grant Recoveries	(191,669)
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Total	\$ 383,027,214

## NOTE 7 MANAGEMENT AND GRANTS OVERSIGHT

Management and grants oversight expenses for the year ended September 30, 2011 were as follows:

	<b>2011</b>
Compensation and benefits	\$ 12,157,984
Temporary employee pay	507,879
Consulting	618,469
Travel and transportation	800,518
Communications	106,815
Occupancy cost	1,730,590
Printing and reproduction	62,706
Other operating expenses	696,319
Capital expenditures	515,182
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Total	17,196,462
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Depreciation & Amortization	225,917
Loss on disposal of assets	268
Less: capitalized assets	(515,448)
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	\$ 16,907,199

## NOTE 8 OFFICE OF INSPECTOR GENERAL

LSC's Office of Inspector General expenses for the year ended September 30, 2011 were as follows:

	<b>2011</b>
Compensation and benefits	\$ 3,579,686
Temporary employee pay	8,408
Consulting	167,188
Travel and transportation	199,678
Communications	17,331
Occupancy cost	1,482
Printing and reproduction	8,271
Other operating expenses	56,668
Capital expenditures	73,246
<b>Total</b>	<b>4,111,958</b>
Less: capitalized assets	(73,246)
	<b>\$ 4,038,712</b>

## NOTE 9 RETIREMENT PLANS

Pursuant to the Legal Services Corporation Act, all officers and employees hired before October 1, 1988, are participants in the Civil Service Retirement System ("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 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

## NOTE 9 RETIREMENT PLANS (Continued)

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 year ended September 30, 2011 were \$994,311. The amounts are included in compensation and benefits 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 10 OPERATING LEASE

On June 1, 2003, LSC commenced an operating lease agreement for office space which provides for a non-escalating annual base rent for a 10-year term. LSC 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 as of September 30, 2011 are as follows:

Fiscal Year	Amount
2012	1,710,000
2013	1,140,000
	\$ 2,850,000

Rental expense for the year ended September 30, 2011 is \$1,710,000.

## NOTE 11 CONTINGENCIES

### 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 numerous 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 auditors.

LSC receives substantially all of its revenue from direct federal government appropriations. Should there be a significant reduction in this revenue, LSC's programs and activities could well be negatively affected.

### Claims

LSC is defending what started as two separate cases but have been consolidated into one case involving challenges to LSC regulations. Plaintiffs are seeking injunctive relief but no monetary damages, except for attorneys' fees but LSC's legal fees in these cases were being paid by its insurance carriers. Insurance is no longer available to cover legal fees in

## NOTE 11 CONTINGENCIES (Continued)

this consolidated matter and must be paid directly by LSC out of normal operating funds, without reimbursement by insurance carriers. However, the matter has been dormant since 2009 and no renewed activity is anticipated. No funds have been recorded in the financial statements for any contingent liability associated with future legal fees.

In August of 2011, a civil lawsuit, *Wojdak v LSC*, U.S. Department of Labor, U.S. Department of the Treasury, was filed against LSC but never served. Although the lawsuit names LSC as a co-defendant, no specific claims were made against LSC. No funds have been recorded in the financial statements for any contingent liability associated with this matter.

Since June of 2011, several employees of LSC have filed wage discrimination complaints with the Equal Employment Opportunity Commission (EEOC). As they were only recently filed, all but one remain pending before the EEOC. Outside counsel for the Corporation has assessed the pending claims and advised that none is meritorious. Given that, in the opinion of counsel, none of these matters poses a reasonable possibility of an unfavorable outcome, no funds have been recorded in the financial statements for any contingent liability associated with these matters.

### **Reclassification of employees from exempt to non-exempt**

No one made a claim against LSC alleging misclassification or failure to pay overtime, but LSC reclassified certain individuals from exempt to nonexempt and retroactively paid wages for hours worked in excess of 37.5 hours per week. Sufficient funds were available to make these payments without affecting current operations. Total amount paid during year ended September 30, 2011 is \$9,448 and the amount due at September 30, 2011 is \$25,782.

### **Collection Matters**

In 2010, upon concluding that an LSC grantee had misused LSC funds and committed other financial irregularities, LSC disallowed approximately \$716,261 of the grantee's costs. On appeal, LSC agreed to reduce that amount to \$467,619. In 2011, the grantee was completely defunded. The Corporation is now exploring its options on how to recover the previously disallowed amount of \$467,619. No amounts have been recorded.

## NOTE 12 LOAN REPAYMENT ASSISTANCE PROGRAM

Through the Herbert S. Garten Loan Repayment Assistance Program (LRAP), established in 2005 and funded by Congressional appropriations, LSC makes a limited number of forgivable loans to attorneys employed by its grantee programs to help repay law school debt. Each participant receives up to \$5,600 per year for three years – for a maximum of \$16,800 if they remain eligible and funding remains available.

Participants must commit to remain with the LSC-funded legal services program for three years. As long as the participant remains in good standing, the loans are forgiven. Participants that do not successfully complete employment within the loan terms must repay the loans. No provision has been made in the accompanying financial statements to reflect any interest on the loans as management has deemed these amounts to be immaterial.

Accounts receivable are stated at the amount management expects to collect from refunded loans. Management provides for probable forgiven amounts through an adjustment to a valuation allowance based on its assessment of the current status of individual accounts. Accounts receivable balances are written-off through a charge to the valuation allowance

## NOTE 12 LOAN REPAYMENT ASSISTANCE PROGRAM (Continued)

in the year the loans are forgiven. Deferred revenue is comprised of funding available for future loans and loan amounts outstanding.

LRAP balances at September 30, 2011 are as follows:

Cash	\$ 1,176,638
Accounts receivable, net	7,535
Deferred revenue	1,184,223

LRAP activity for the year ended September 30, 2011 is as follows:

Loans made	\$ 1,518,607
Loans forgiven	866,953
Net change in allowance for loan forgiveness	650,693

## NOTE 13 TEMPORARILY RESTRICTED NET ASSET

LSC received donations totaling \$12,500 which are restricted for the American Bar Foundation *Access Across America* research project.

## NOTE 14 PRIOR PERIOD ADJUSTMENT

During the FY 2011 audit, the decision was made to set up an allowance for the Herbert S. Garten Loan Repayment Assistance Program to properly report the Loan Repayment Assistance Program Receivable at its net realizable value in accordance with generally accepted accounting principles. The total amount of the adjustment related to FY2010 was \$463,084 causing the accounts receivable to be adjusted from \$479,860 to \$16,776 on the statement of financial position and the Herbert S. Garten Loan Repayment Assistance Program expense to be adjusted from \$572,162 to \$990,246 on the statement of changes in net assets. In addition, the adjustment caused the deferred revenue to be adjusted from \$6,418,891 to \$5,955,807 on the statement of financial position and the change in deferred revenue to be adjusted from \$3,619,052 to \$3,155,968 on the statement of activities. These changes had no effect on the net assets of LSC at September 30, 2010.

## NOTE 15 SUBSEQUENT EVENTS

Legal Services Corporation has evaluated subsequent events occurring after the statements of financial position date through the date of January 9, 2012 the date the financial statements were available for release.

### *Fiscal Year 2012 Funding*

On November 17, 2011, the House and Senate passed the Conference Report (House Report 112-284) to accompany H.R. 2122, an appropriations bill for Fiscal Year 2012 that included \$348 million for the Legal Services Corporation. President Obama signed the bill into law (Public Law 112-55) on November 18.

## **NOTE 15 SUBSEQUENT EVENTS (Continued)**

The appropriations bill, popularly known as the “minibus,” combined the Agriculture, Commerce-Justice-Science and Transportation-HUD spending bills. LSC is funded through the Commerce, Justice, Science and Related Agencies Appropriations Subcommittee.

The Fiscal Year 2012 appropriation will provide \$322.4 million for basic field grants, \$3.4 million for the Technology Initiative Grants program, \$1 million for the student loan repayment assistance program, \$17 million for management and grants oversight, and \$4.2 million for the LSC Office of Inspector General. Prior to enactment, LSC operated on funds provided by a Continuing Resolution (Public Law 112-36) that cut all accounts by 1.5 percent and expired on November 18, 2011. LSC was funded at \$398 million under the interim bill.

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**Previous auditors' reports are available in LSC's annual reports:**

[www.LSC.gov/about/annual-report](http://www.LSC.gov/about/annual-report)