

# Financials

Financial Statements and Independent Auditor's Report For The Year Ended  
September 30, 2010

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## INDEPENDENT AUDITOR'S REPORT

To The Inspector General and the Board of Directors  
Legal Services Corporation  
Washington, DC

We have audited the accompanying statements of financial position of the Legal Services Corporation ("LSC") as of September 30, 2010 and 2009, and the related statements of activities and cash flows 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 *Government Auditing Standards*. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of LSC as of September 30, 2010 and 2009, and the results of its activities and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The Management's Discussion and Analysis on pages 17 to 31 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 express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 7, 2011 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 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.

Washington, DC  
January 7, 2011

*Thompson, Cobb, Bazilio & Associates, PC*

*Financial Statements***Statement of Financial Position****September 30, 2010 and 2009**

<b>ASSETS</b>	<b>2010</b>	<b>2009</b>
Cash and cash equivalents	\$ 83,596,411	\$ 77,940,065
Accounts receivable	479,860	625,342
Prepaid expenses and deposits	380,544	178,663
Fixed assets, net	391,997	395,244
<b>Total Assets</b>	<b>\$ 84,848,812</b>	<b>\$ 79,139,314</b>
 <b>LIABILITIES</b>		
Grants and contracts payable	\$ 69,431,311	\$ 68,335,697
Accounts payable	358,309	302,383
Accrued vacation and other liabilities	1,011,649	1,236,290
Deferred revenue	6,418,891	2,800,129
<b>Total Liabilities</b>	<b>77,220,160</b>	<b>72,674,499</b>
 <b>NET ASSETS</b>		
Unrestricted net assets:		
Designated	553,445	835,863
Undesignated	6,683,210	5,233,709
Net investment in fixed assets	391,997	395,243
<b>Total unrestricted net assets</b>	<b>7,628,652</b>	<b>6,464,815</b>
<b>Total liabilities and unrestricted net assets</b>	<b>\$ 84,848,812</b>	<b>\$ 79,139,314</b>

*Financial Statements (cont.)***Statement of Activities****Year Ended September 30, 2010 and 2009**

<b>SUPPORT AND REVENUE</b>	<b>2010</b>	<b>2009</b>
Federal appropriations	\$ 420,000,000	\$ 390,000,000
Grant revenue	1,820,290	2,034,086
Interest	6,305	39,379
Other income	10,802	6,598
Change in deferred revenue	(3,619,052)	(1,370,641)
<b>Total support and revenue</b>	<b>418,218,345</b>	<b>390,709,422</b>
<b>EXPENSES</b>		
Program activities:		
Grants, contracts and reimbursable expenses	396,661,702	371,257,115
Supporting activities:		
Management and grants oversight	16,125,945	13,845,616
Office of Inspector General	3,739,699	3,270,879
Herbert S. Garten Loan Repayment Assistance Program	527,162	279,400
<b>Total supporting activities</b>	<b>20,392,806</b>	<b>17,395,895</b>
<b>Total expenses</b>	<b>417,054,508</b>	<b>388,653,010</b>
Change in net assets	1,163,837	2,056,412
Unrestricted net assets, beginning of year	6,464,815	4,408,403
Unrestricted net assets, end of year	\$ 7,628,652	\$ 6,464,815

*Financial Statements (cont.)***Statement of Cash Flows****Year Ended September 30, 2010 and 2009****CASH FLOWS FROM OPERATING ACTIVITIES**

	<b>2010</b>	<b>2009</b>
Change in net assets	\$ 1,163,837	\$ 2,056,412
Adjustments to reconcile change in net assets to net cash and cash equivalents provided by operating activities:		
Depreciation and amortization	312,261	215,810
Loss on disposal of assets	103	583
Decrease (increase) in accounts receivable	47,129	(31,106)
Decrease (increase) in LRAP receivable	98,354	(249,480)
(Increase) decrease in prepaid expenses and deposits	(201,882)	53,560
Increase in grants and contracts payable	1,095,614	6,822,430
Increase in accounts payable	55,926	76,049
(Decrease) increase in accrued vacation and other liabilities	(224,641)	270,493
Increase in deferred revenue	3,618,762	1,366,555
Net cash and cash equivalents provided by operating activities	5,965,463	10,581,306

**CASH FLOWS FROM INVESTING ACTIVITIES**

Purchases of fixed assets	(309,117)	(93,347)
Net cash and cash equivalents used in investing activities	(309,117)	(93,347)
Net increase in cash and cash equivalents	5,656,346	10,487,959
Cash and cash equivalents, beginning of year	77,940,065	67,452,106
Cash and cash equivalents, end of year	\$ 83,596,411	\$ 77,940,065

*Notes To Financial Statements* September 30, 2010**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES****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.

**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.

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 does not have temporarily or permanently net assets.

**Estimates**

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

**Cash and Cash Equivalents**

LSC considers all money market funds and instruments with a maturity date of less than 90 days to be cash equivalents. LSC's cash accounts are subject to Federal Deposit Insurance Corporation (FDIC) limits. The FDIC temporarily increased the maximum limit from \$100,000 to \$250,000 through December 31, 2013. LSC has established target balances above \$250,000 and transfers the amounts on a daily basis into government backed securities accounts under a sweep arrangement.

**Support and Revenue**

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

**Grantee Receivables and 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, as well as other types of recoveries.

*Notes To Financial Statements (cont.)* September 30, 2010**NOTE 1 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.

**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 and ten years.

**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.

**Classification of 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.

**Concentration of Revenue**

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

**NOTE 2 CASH AND CASH EQUIVALENTS**

Cash and cash equivalents consist of cash on deposit at financial institutions and undisbursed appropriations, which constitute spending authority remaining available in LSC's account held by the U.S. Treasury. Cash and cash equivalents as of September 30, 2010 and 2009 consisted of the following:

	<b>2010</b>	<b>2009</b>
Cash in U.S. Treasury	\$ 46,139,618	\$ 41,663,198
Cash in financial institution	37,454,793	36,274,867
Petty cash	2,000	2,000
<b>Total cash and cash equivalents</b>	<b>\$ 83,596,411</b>	<b>\$ 77,940,065</b>

*Notes To Financial Statements (cont.)* September 30, 2010**NOTE 3 FIXED ASSETS**

Fixed assets as of September 30, 2010 and 2009 consisted of the following:

	<b>2010</b>	<b>2009</b>
Furniture and equipment	\$ 1,939,454	\$ 1,824,982
Software	406,050	341,201
Leasehold improvements	351,698	321,687
Subtotal	2,697,202	2,487,870
Less: accumulated depreciation and amortization	(2,305,205)	(2,092,626)
Fixed assets, net	\$ 391,997	\$ 395,244

**NOTE 4 GRANT REVENUE**

LSC was awarded a grant from the U.S. Court of Veterans Appeals for the purpose of furnishing legal assistance to veterans in non-criminal proceedings.

Additionally, LSC was awarded a grant from the State Justice Institute, a nonprofit organization established by federal law, for the purpose of expanding the number of LSC technology initiative grants.

Grant revenue for the years ended September 30, 2010 and 2009 consisted of the following:

	<b>2010</b>	<b>2009</b>
U.S. Court of Veterans Appeals grant	\$ 1,805,000	\$ 1,700,000
Veterans reimbursable expenses	15,290	4,086
State Justice Institute	-	330,000
Total grant revenue	\$ 1,820,290	\$ 2,034,086

**NOTE 5 GRANT AND CONTRACT EXPENSES**

Grant and contract expenses for the years ended September 30, 2010 and 2009 were as follows:

	<b>2010</b>	<b>2009</b>
Basic Field Programs	\$ 394,582,437	\$ 365,745,172
U.S. Court of Veterans Appeals Funds	1,820,290	1,704,086
Technology Initiatives	300,000	3,705,628
Grants From Other Funds	71,349	283,734
Grant Recoveries	(112,374)	(181,505)
Total grant and contract expenses	\$ 396,661,702	\$ 371,257,115

*Notes To Financial Statements (cont.)* September 30, 2010**NOTE 6 MANAGEMENT AND GRANTS OVERSIGHT**

Management and grants oversight expenses for the years ended September 30, 2010 and 2009 were as follows:

	<b>2010</b>	<b>2009</b>
Compensation and benefits	\$ 11,449,159	\$ 9,917,209
Temporary employee pay	142,208	67,549
Consulting	933,677	686,858
Travel and transportation	689,808	494,432
Communications	121,042	132,567
Occupancy cost	1,708,406	1,654,289
Printing and reproduction	91,249	50,659
Other operating expenses	674,582	625,185
Capital expenditures	269,743	61,435
<b>Total</b>	<b>16,079,874</b>	<b>13,690,183</b>
Depreciation and amortization	312,261	215,810
Loss on disposal of assets	103	583
Less: capitalized assets	(266,293)	(60,960)
<b>Total management and grant oversight expenses</b>	<b>\$ 16,125,945</b>	<b>\$ 13,845,616</b>

**NOTE 7 HERBERT S. GARTEN LOAN REPAYMENT ASSISTANCE PROGRAM**

LSC initiated the Herbert S. Garten Loan Repayment Assistance Program in 2006 and loans were provided up to \$5,000 annually for participating attorneys. In 2007, loans increased to \$5,600 annually. For the years ended September 30, 2010 and 2009, participating attorneys received loans totaling \$470,669 and \$569,023, respectively, which have been included in accounts receivable.

The loans forgiven in fiscal years 2010 and 2009 totaled \$527,162 and \$279,400, respectively. Each loan and the related interest are to be forgiven provided that the participating attorneys successfully complete employment within the loan terms. No provision has been made in the accompanying financial statements to reflect any loss that may occur and no interest on the loans has been accrued as management has deemed these amounts to be immaterial.

*Notes To Financial Statements (cont.)* September 30, 2010**NOTE 8 OFFICE OF INSPECTOR GENERAL**

LSC's Office of Inspector General expenses for the years ended September 30, 2010 and 2009 were as follows:

	<b>2010</b>	<b>2009</b>
Compensation and benefits	\$ 3,408,921	\$ 2,977,165
Temporary employee pay	-	9,531
Consulting	92,844	65,570
Travel and transportation	164,906	145,626
Communications	16,012	22,138
Printing and reproduction	2,963	3,109
Other operating expenses	54,053	47,740
Capital expenditures	42,825	32,387
<b>Total</b>	<b>3,782,524</b>	<b>3,303,266</b>
<b>Less: capitalized assets</b>	<b>(42,825)</b>	<b>(32,387)</b>
<b>Total Office of Inspector General expenses</b>	<b>\$ 3,739,699</b>	<b>\$ 3,270,879</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 Revenue Code. Individuals can make contributions up to the maximum permitted by law.

*Notes To Financial Statements (cont.)* September 30, 2010**NOTE 9 RETIREMENT PLANS (Continued)**

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, 2010 and 2009 were \$973,980 and \$858,469, respectively. These 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 LEASES****Related Party Lease**

On June 1, 2003, LSC commenced an operating lease agreement for office space with the Friends of Legal Services Corporation ("FoLSC"), a nonprofit corporation whose primary purpose is to carry out 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,	
2011	1,710,000
2012	1,710,000
2013	1,140,000
Total	\$ 5,130,000

Rental expense for each of the years ended September 30, 2010 and 2009 was \$1,710,000. No amounts were due to or due from FoLSC as of September 30, 2010 and 2009.

**Sublease**

During fiscal year 2005, LSC entered into a five-year sublease to lease a portion of its space. The lease agreement provided for an annual base rent of \$53,415 with a 2% annual increase. The sublease expired during fiscal year 2010.

Total sublease income recognized in fiscal year 2010 was approximately \$4,824 and was reported as a reduction of rental expense in the accompanying financial statements.

*Notes To Financial Statements (cont.)* September 30, 2010**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 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 auditors.

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

**Claims**

LSC is defending three cases in litigation involving challenges to LSC regulations, two of which have been consolidated. In the consolidated cases, plaintiffs are seeking injunctive relief but no monetary damages, except for attorneys' fees. The third case (LASO) involves a claim for injunctive relief but no monetary damages except for costs. Prior to 2008, the fees in these cases were paid by LSC's insurance carriers, but one carrier disputed coverage. LSC sued the carriers and settled in fiscal year 2008 for approximately \$400,000. All future legal fees in these cases will be paid directly by LSC out of normal operating funds, and not be reimbursed by insurance carriers. No funds have been recorded in the financial statements for any contingent liability associated with future legal fees.

There is one further case, which was filed in December 2008 but which has never been served. In that case, plaintiff claims wrongful denial of legal representation by a LSC grantee. The suit appears to be entirely without merit. No outside counsel has been retained and no attorneys' fees or costs have been incurred.

LSC does not believe the result of these claims will have a material negative effect on its financial statements.

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

Certain individuals may be misclassified as exempt from overtime and may be due wages for hours worked in excess of forty hours per week. Although none of these individuals has yet asserted a misclassification or failure to pay overtime claim against LSC, LSC has sought legal advice with respect to the potential liability, should any claim be made, strategy for resolving the matters, re-classifying these employees, and analysis of potential cost to resolve any overtime issues prior to claims being filed. LSC is in the process of estimating the time that it believes each individual may claim to have worked overtime based on observation and experience working with each of them. As no claims have been made, it is not certain at this time whether the employees will agree with LSC's time estimates. LSC believes it has sufficient funds available to make any payment without affecting current operations.

**NOTE 12 TAX STATUS**

Under Section 501(c)(3) of the Internal Revenue Code, LSC is exempt from the payment of taxes on income other than net unrelated business income. No provision for income taxes was required for the years ended September 30, 2010 and 2009 as LSC had no net unrelated business income.

In June 2006, FASB ASC 740-10, *Accounting for Uncertainty in Income Taxes*, was issued. FASB ASC 740-10 clarifies the accounting and disclosure for uncertain tax positions, and prescribes a threshold of more-likely-than-not for recognition and derecognition of tax positions taken or expected to be taken in a tax return. During the year ended September 30, 2010, LSC adopted FASB ASC 740-10 and believes there is no impact on its financial statements.

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, 2010 and 2009.

**NOTE 13 SUBSEQUENT EVENTS**

In preparing these financial statements, LSC has evaluated events and transactions for potential recognition or disclosure through January 7, 2011, the date the financial statements were issued.

***Continuing Resolution***

For fiscal year 2011, the House Appropriations Committee has proposed to increase LSC's funding to \$440 million and the Senate Appropriations Subcommittee has recommended an increase to \$430 million. The LSC Board had requested that Congress approve \$516.5 million for fiscal year 2011. Congress had not approved the fiscal year 2011 appropriation for LSC by October 1, 2010; therefore LSC began the new fiscal year operating at fiscal year 2010 funding levels, under a Continuing Resolution signed into law on December 22, 2010. The new continuing resolution will provide funding through March 4, 2011.

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**Other reports issued by the auditor are available online at:**

<http://www.oig.lsc.gov/reports/corp/fy%202010%20LSC%20Corporate%20Audit.pdf>