

**PENNSYLVANIA INTEREST ON LAWYERS
TRUST ACCOUNT BOARD**

FINANCIAL STATEMENTS
WITH SUPPLEMENTARY INFORMATION
YEARS ENDED JUNE 30, 2004 AND 2003
AND
INDEPENDENT AUDITOR'S REPORT

PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Pennsylvania Interest on Lawyers Trust Account Board
Harrisburg, Pennsylvania

We have audited the accompanying basic financial statements of the Pennsylvania Interest on Lawyers Trust Account Board, a component unit of the Commonwealth of Pennsylvania, as of and for the years ended June 30, 2004 and 2003, as listed in the table of contents. These financial statements are the responsibility of the Board'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. 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 the Pennsylvania Interest on Lawyers Trust Account Board as of June 30, 2004 and 2003, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 3 to 10 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information on pages 21 through 25 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information, except for the portion marked "unaudited," on which we express no opinion, has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly presented in all material respects in relation to the basic financial statements taken as a whole.

McKonly & Asbury, LLP

Harrisburg, Pennsylvania
July 27, 2004

PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2004
UNAUDITED

INTRODUCTION

The following discussion and analysis of the financial performance and activity of the Pennsylvania Interest on Lawyers Trust Account Board (IOLTA Board) is to provide an introduction and understanding of the basic financial statements of the IOLTA Board for the fiscal year ending June 30, 2004 with selected comparative information for the fiscal year ending June 30, 2003. This discussion has been prepared by management and is unaudited; and should be read in conjunction with the financial statements and their notes, which follow this section.

An Interest on Lawyers Trust Account (IOLTA) Program exists in each state and the District of Columbia. In some states, the underlying authority for the program is a state statute; however, in most, it is by rule promulgated by the state's highest court. In Pennsylvania, the IOLTA Program was initially established by statute in 1989, but in 1996, the Supreme Court of Pennsylvania suspended the statute, assumed jurisdiction for the program in accordance with Pennsylvania's constitution, and made participation in the program mandatory by all licensed Pennsylvania lawyers.

The concept of the IOLTA program is simple. Clients and others frequently transfer money to lawyers to hold. When the amount is large or if the funds will be held for an extended period of time, lawyers invest them for the benefit of the client or third party. But, when the funds are small or expected to be held for a short time, they cannot practically be invested to benefit the owner. Pennsylvania Rule of Professional Conduct (RPC) 1.15 requires lawyers to maintain nominal and short term fiduciary funds in interest-bearing IOLTA accounts at financial institutions. Lawyers who infrequently handle fiduciary funds can request an exemption from the IOLTA requirements of the RPC. The lawyer's bank transfers the interest earned on IOLTA accounts to the IOLTA Board. Upon approval by the Supreme Court of Pennsylvania, the IOLTA Board distributes the IOLTA funds raised to non-profit organizations, law school administered clinical and externship programs, and administration of justice projects all of which provide civil legal services free of charge to poor and disadvantaged Pennsylvania residents.

Until the fiscal year ended June 30, 2003, the IOLTA Board's single major source of revenue had been the collection of interest earned on IOLTA accounts. Revenue generated by IOLTA accounts is dependent on the interest rate(s) credited by financial institutions on IOLTA accounts, service charges offset against the IOLTA interest, and the principal amount of funds maintained in the IOLTA accounts. Although IOLTA revenue can also be affected by the extent of lawyer compliance with the RPC, compliance is and has been nearly 100%.

Effective November 1, 2002, a second significant revenue source was established. A statute, Act 122 of 2002, a section of which is known as the Access to Justice Act (AJA), provides for the assessment and collection of a surcharge on all civil filings, as well as the recording of deeds and mortgages and their related filings, and criminal filings where a conviction or a guilty plea is obtained (see Note 5 to the financial statements). For the period November 1, 2002 to June 30, 2003, \$2.9 million and for the fiscal year ending June 30, 2004, \$7.7 million of such charges were earmarked for the IOLTA Board's grants program targeted to civil legal services provided by non-profit legal aid organizations. The amount of the surcharge that is earmarked for the IOLTA Board is scheduled for legislative review before November 1, 2007 under a sunset provision of the statute.

(continued)

PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2004
UNAUDITED

INTRODUCTION (Cont'd)

The IOLTA Board also receives some limited funding from voluntary lawyer contributions. Each year lawyers must renew their license to practice law in Pennsylvania, report information, and pay an annual assessment to the Disciplinary Board of the Supreme Court of Pennsylvania. Included in the mailing of the Annual Attorney Fee Form by the Disciplinary Board is an enclosure that requests a contribution that will be used to increase the organized pro bono representation of indigent Pennsylvania residents by lawyers in private practice. Pro bono representation is the provision of legal assistance by lawyers without the expectation of a fee for the services.

IOLTA BOARD'S ACTIVITY HIGHLIGHTS

National and other studies have concluded that only one of five indigent persons needing civil legal assistance actually receives the needed legal help. As a result, legal assistance is often rationed to those whose needs are determined the greatest, such as victims of domestic violence, tenants and homeowners facing the loss of housing, and families facing the loss of income.

All of the IOLTA Board's grants are directed to maintaining and increasing the access to and provision of civil legal assistance for Pennsylvania residents who need civil legal help, but who cannot afford to pay for the assistance of a lawyer. An additional objective of its grants to law schools and pro bono programs is to instill a public service, pro bono ethic in the law students and lawyer participants of the programs.

The IOLTA Board also seeks to increase the amount of revenue it has available for such grants. Finally, the IOLTA Board keeps track of lawyer compliance with the IOLTA requirements of RPC 1.15.

Overall Grant Activities

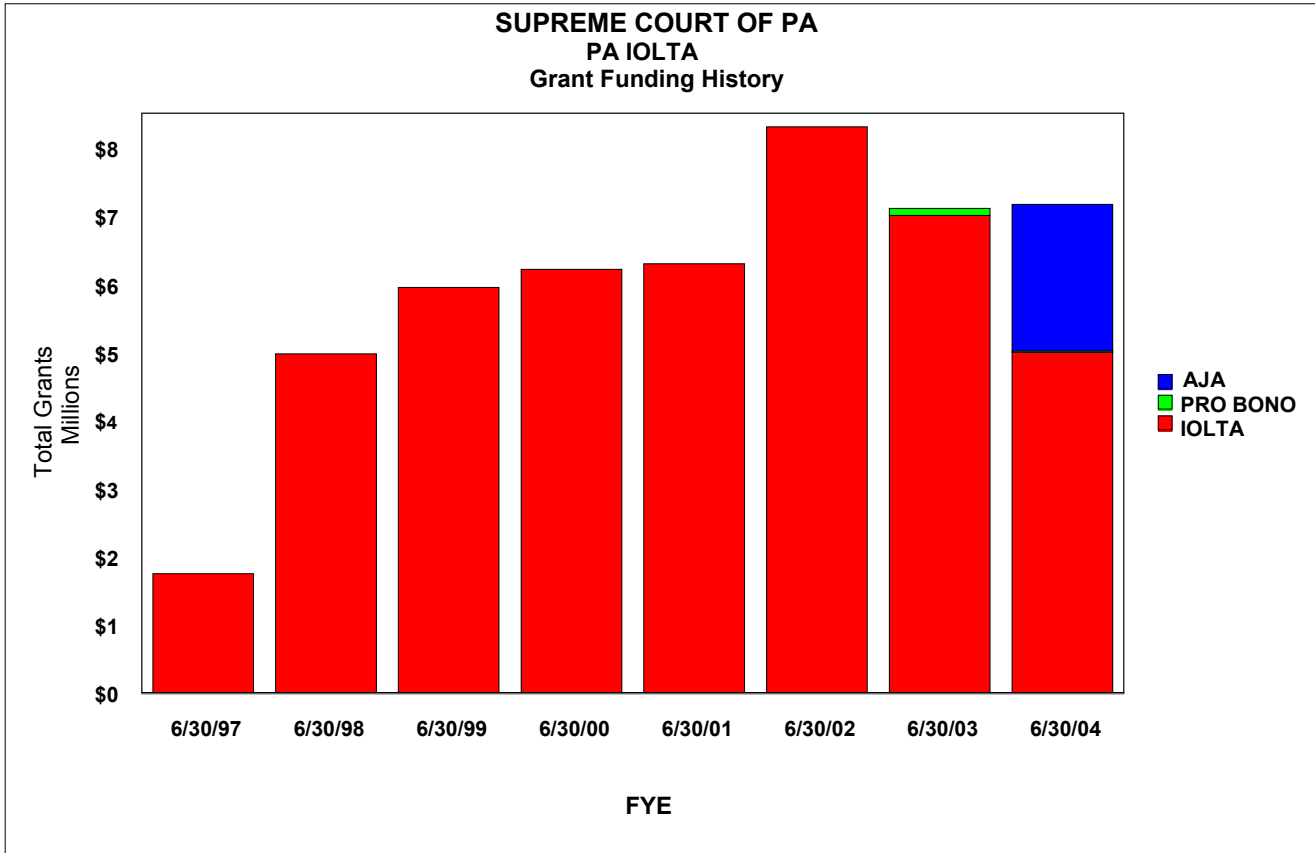
Since the inception of the IOLTA program in Pennsylvania through June 30, 2004, about \$63.4 million of grants have been awarded (nearly \$47.8 of which were awarded while the IOLTA program was under the jurisdiction of the Supreme Court - see graph on the following page). As can be observed from the graph displaying the grant funding history, IOLTA funded grants declined from their peak of \$8.3 million in fiscal year ending June 30, 2002 to \$5 million for the last fiscal year, a decline of almost 40% in two years.

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PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2004
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IOLTA BOARD'S ACTIVITY HIGHLIGHTS (Cont'd)



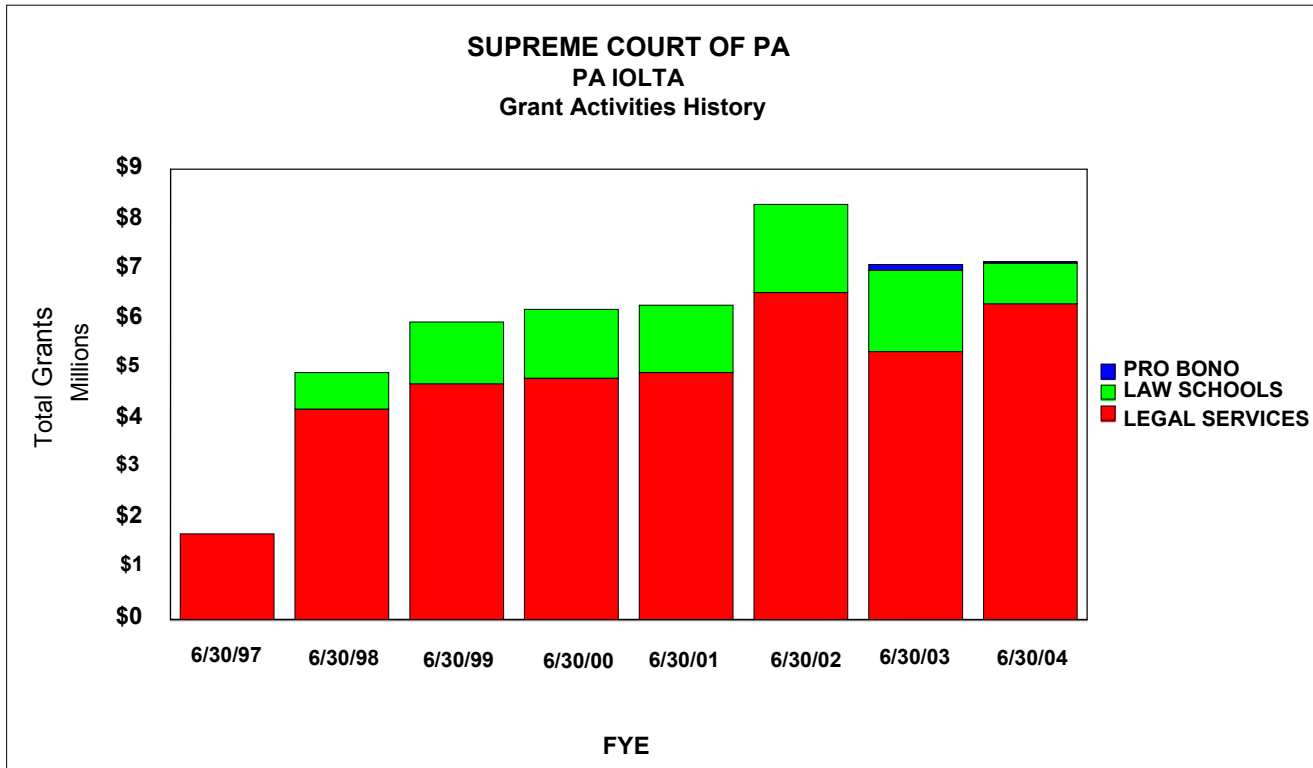
Since the inception of IOLTA in 1989, most grants, \$54.3 million, have gone to legal services organizations, almost \$9 million to law school clinical and externship programs, and about \$115,000 to establish or expand county-based pro bono efforts. Until the enactment of the Access to Justice (AJA) statute, the grants were funded by IOLTA revenues and private attorney contributions.

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PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2004
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IOLTA BOARD'S ACTIVITY HIGHLIGHTS (Cont'd)



With the infusion of new AJA funds last year, grant awards to legal services organizations have remained relatively stable over the years. All of the AJA funding must be awarded to legal aid organizations. However, without the new AJA funding, grants to legal services organizations would have declined by 30% last year.

Since law schools do not receive any of the new AJA funds, grants last year declined to their lowest level since the IOLTA funding of law school efforts began. As compared to the previous year, grants to law schools declined nearly 50%. Without additional funding for this grant priority, future grants may continue to decline (however, see "revenue enhancement" below).

Revenue Enhancement

Grant funds for law school clinics and internships have declined dramatically and were likely to continue declining because of historically low interest rates on IOLTA accounts. When the Court's IOLTA program began in 1996, a goal funding of \$250,000 was established for each law school. Law schools must plan their clinical and internship programs a year in advance to assure they can staff the clinics to accommodate student enrollment. The wide fluctuation of the IOLTA grants to the law schools last year and the likelihood of continued instability caused great planning difficulties for the law schools.

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PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2004
UNAUDITED

IOLTA BOARD'S ACTIVITY HIGHLIGHTS (Cont'd)

New funding from the AJA allowed legal services organizations relatively stable funding through the Board; but without additional funding, the laws schools were realizing the full effects of the declining IOLTA revenues. Additionally, the IOLTA Board had to use nearly all of its cash reserves to fund its grants last year, and its cash position would be very precarious without additional funding.

Given these unusual and pressing circumstances, the Supreme Court of Pennsylvania authorized the transfer of \$1.4 million from the Lawyers Fund for Client Security (LFCS) to the IOLTA Board. The LFCS is an unrelated organization that also operates under the jurisdiction of the Court. This one-time transfer allows the Board to re-establish its cash position, award stabilizing grant amounts to the law school clinics and internships without affecting the planned grants to legal services organizations, and provides time for the Board to explore potential alternative funding sources, or policy alternatives, to stabilize the law school grants program.

Attorney Compliance

Each year, the IOLTA Board notifies approximately 1,500 newly licensed Pennsylvania lawyers of their IOLTA responsibilities. Additionally, each year, the IOLTA Board compares fiduciary account information lawyers report to the Disciplinary Board of the Supreme Court of Pennsylvania attempting to locate IOLTA accounts established by lawyers at their financial institutions but which are not being reported to the IOLTA Board by the financial institutions. Contact is made with lawyers who report escrow accounts that should be established as IOLTA accounts, but which have not yet been so established by the lawyer.

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PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2004
UNAUDITED

COMMENTS ON FINANCIAL STATEMENTS

Condensed financial data extracted from the basic financial statements for the fiscal years ended June 30, 2004 and 2003 is as follows:

	2004	2003
Capital assets	\$ 19,072	\$ 13,101
Other assets	10,617,406	3,991,210
Total assets	\$ 10,636,478	\$ 4,004,311
Total current liabilities	\$ 147,381	\$ 106,766
Invested in capital assets	19,072	13,101
Restricted net assets	10,362,921	3,824,872
Unrestricted net assets	107,104	59,572
Total net assets	10,489,097	3,897,545
Total liabilities and net assets	\$ 10,636,478	\$ 4,004,311
IOLTA interest, net of service charges	\$ 4,741,212	\$ 5,879,267
Access to Justice fees	7,659,679	2,942,829
Total operating revenues	12,400,891	8,822,096
Program administration	410,251	464,017
Grant awards		
Legal service organizations	6,006,015	5,356,000
Law schools	844,113	1,649,861
Pro bono grants	17,151	97,735
Total grant awards	6,867,279	7,103,596
Total operating expenses	7,277,530	7,567,613
Total non-operating revenues	1,468,191	54,546
Change in net assets	6,591,552	1,309,029
Net assets - July 1	3,897,545	2,588,516
Net assets - June 30	\$ 10,489,097	\$ 3,897,545

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PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2004
UNAUDITED

COMMENTS ON FINANCIAL STATEMENTS (Cont'd)

Major Changes

Three major revenue themes have had a significant impact on the Board's financial statements. First, the Access to Justice Act (AJA) provides that the Board receives an increase in the proportion of certain filing fee surcharges that it receives. The percentage of such surcharges increased from 10% in the fiscal year ending June 30, 2003 (2003) to 15% in the fiscal year ending June 30, 2004 (2004). As a result, AJA revenues increased from \$2.9 million in 2003 (for 8 months) to \$7.7 million in 2004 (for 12 months).

Second, IOLTA revenues from attorney IOLTA accounts continued to decline for the third consecutive year. As compared to 2003, IOLTA revenues were down \$1.1 million or a 19% reduction. IOLTA revenues are sensitive to interest rates, and with interest rates declining over the last several years, IOLTA revenues have as well.

Lastly, due to declining IOLTA revenues and the likely impact on the law school grant program, the Supreme Court of Pennsylvania (Court) authorized a one time transfer of \$1.4 million from the Lawyer Fund for Client Security (LFCS), a separate organization which also operates under the jurisdiction of the Court.

Total net assets increased from June 30, 2003 to June 30, 2004 by \$6.6 million primarily as a result of the increased receivable from the Commonwealth of PA due to the increased AJA percentage, and the transfer of funds from LFCS authorized by the Court.

Change in net assets was \$6.6 million in 2004, or about \$5.3 million greater than 2003, primarily as a result of the net revenue events described above. This resulted in the increase in restricted net assets between the years of \$6.5 million.

Legal Services Organization Grants

Grants totaling \$6,006,015 and \$5,356,000 were awarded in fiscal years ended June 30, 2004 and 2003 to thirty-four non-profit organizations that facilitate and/or provide civil legal assistance to the indigent and disadvantaged residents of Pennsylvania. The largest grant this past year, over \$5.3 million was awarded to Pennsylvania Legal Services which is an administrative and support organization that oversees a statewide system of legal aid programs (the Pennsylvania Legal Aid Network) that is staffed by professional poverty law lawyers. That grant sought to provide general and specialized civil legal assistance to over 20,000 indigent persons in all sixty-seven counties in Pennsylvania.

Direct grants were made to some of the organizations of the Pennsylvania Legal Aid Network, which were targeted to increase the access to civil legal help by assisting the organizations to implement and maintain region-wide telephone "help lines". Help lines make use of an 800 number that callers from the area served by the program can use to seek legal assistance. After financial eligibility for

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PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2004
UNAUDITED

COMMENTS ON FINANCIAL STATEMENTS (Cont'd)

services is determined, callers requiring direct representation are routed to the appropriate service office to schedule an appointment. Clients needing legal advice are immediately transferred to lawyers staffing the telephone help line. Other grants were awarded to help remove legal barriers confronting individuals who were moving from public welfare to employment. Clients in such transition often need assistance with child care, health benefits, and transportation among other needs. Legal Aid programs were funded to help those individuals gain the assistance needed for a successful transition.

Grants were also awarded to civil legal service organizations that represent the disabled, victims of abuse, elderly, farm workers, institutionalized, or to provide specialized legal help for health, immigration, and other areas.

Law School Clinics and Internship Programs

Grants were awarded to each of the seven Pennsylvania law schools to help fund clinical programs that provide practical, supervised representational experiences for law students, as well as, civil legal help for the indigent. The total IOLTA grant awards to the law schools were \$844,113 and \$1,649,861 in fiscal years ended June 30, 2004 and 2003. Each school received at least a \$111,930 and \$250,000 grant respectively. Fourteen clinics operated by the law schools received IOLTA grant support. The IOLTA grant for a clinic usually provided 50% to 60% of the direct cost of operating the clinic. At one law school, the IOLTA grant helped it initiate a farm workers' clinic, the first of its kind in the United States. At another school, the IOLTA funding helped it initiate an immigration law clinic. Externships at poverty law offices were also planned for students, who would provide civil legal representation under the supervision of experienced poverty law practitioners for a small stipend, but without receiving law school credits for it.

Pro Bono

Organized pro bono programs were funded in four counties. The grants were expected to help mobilize 177 lawyer volunteers to provide civil legal assistance for the indigent.

PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

BALANCE SHEETS

JUNE 30, 2004 AND 2003

ASSETS

	<u>2004</u>	<u>2003</u>
Current assets		
Cash	\$ 1,721,716	\$ 545,252
Accounts receivable		
IOLTA interest	480,000	495,000
Access to Justice	8,365,064	2,942,829
Other	42,341	2,027
Prepaid expenses	8,285	6,102
	<u>10,617,406</u>	<u>3,991,210</u>
Capital assets	119,422	105,509
Accumulated depreciation	<u>(100,350)</u>	<u>(92,408)</u>
	<u>19,072</u>	<u>13,101</u>
Total assets	<u><u>\$ 10,636,478</u></u>	<u><u>\$ 4,004,311</u></u>

LIABILITIES AND NET ASSETS

Current liabilities		
Accounts payable		
Legal service organizations	\$ 98,950	\$ 65,360
Law schools	7,665	-
Other	15,497	26,179
Accrued expenses	25,269	15,227
	<u>147,381</u>	<u>106,766</u>
Total current liabilities		
Net assets		
Invested in capital assets	19,072	13,101
Restricted to IOLTA program	1,991,246	897,104
Restricted to Access to Justice Program	8,371,675	2,927,768
Unrestricted	107,104	59,572
	<u>10,489,097</u>	<u>3,897,545</u>
Total net assets		
Total liabilities and net assets	<u><u>\$ 10,636,478</u></u>	<u><u>\$ 4,004,311</u></u>

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

PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

YEARS ENDED JUNE 30, 2004 AND 2003

	<u>2004</u>	<u>2003</u>
Operating revenues		
IOLTA interest, net of service charges of \$229,563 and \$240,315	\$ 4,741,212	\$ 5,879,267
Access to Justice fees	7,659,679	2,942,829
Total operating revenues	<u>12,400,891</u>	<u>8,822,096</u>
Operating expenses		
Program administration	410,251	464,017
Grant awards		
Legal service organizations	6,006,015	5,356,000
Law schools	844,113	1,649,861
Pro bono grants	17,151	97,735
Total grant awards	<u>6,867,279</u>	<u>7,103,596</u>
Total operating expenses	<u>7,277,530</u>	<u>7,567,613</u>
Operating income	<u>5,123,361</u>	<u>1,254,483</u>
Non-operating revenues		
Contributions		
Pro Bono Initiative	64,683	45,752
Lawyer Fund for Client Security	1,400,000	-
Interest	3,508	8,794
Total non-operating revenues	<u>1,468,191</u>	<u>54,546</u>
Change in net assets	6,591,552	1,309,029
Net assets - July 1	<u>3,897,545</u>	<u>2,588,516</u>
Net assets - June 30	<u>\$ 10,489,097</u>	<u>\$ 3,897,545</u>

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

PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

STATEMENTS OF CASH FLOWS

YEARS ENDED JUNE 30, 2004 AND 2003

	2004	2003
Cash flows from operating activities		
IOLTA interest received	\$ 4,756,212	\$ 6,026,396
Access to Justice	2,237,444	-
Cash paid to grant recipients	(6,826,024)	(7,079,836)
Cash paid to suppliers	(180,838)	(190,292)
Cash paid to employees	(207,758)	(239,336)
Other cash payments	(56,849)	(16,156)
	(277,813)	(1,499,224)
Cash flows from non-capital financing activities		
Contributions:		
Pro Bono Initiative	64,683	45,752
Lawyer Fund for Client Security	1,400,000	-
	1,464,683	45,752
Cash flows from capital and related financing activities		
Acquisition of capital assets	(13,914)	(4,420)
	(13,914)	(4,420)
Cash flows from investing activities		
Interest	3,508	8,794
	3,508	8,794
Increase (decrease) in cash and cash equivalents	1,176,464	(1,449,098)
Cash - beginning	545,252	1,994,350
Cash - ending	\$ 1,721,716	\$ 545,252
Reconciliation of operating income to net cash used in operating activities		
Operating income	\$ 5,123,361	\$ 1,254,483
Adjustments to reconcile change in net assets to net cash used in operating activities		
Depreciation expense	7,943	9,912
Changes in assets and liabilities:		
Accounts receivable	(5,447,549)	(2,795,700)
Prepaid expenses	(2,183)	31
Accounts payable	30,573	34,358
Accrued expenses	10,042	(2,308)
Net cash used in operating activities	\$ (277,813)	\$ (1,499,224)

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

PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

On July 17, 1996, the Supreme Court of Pennsylvania amended Rule 1.15 of the Pennsylvania Rules of Professional Conduct which governs Pennsylvania attorneys' handling of fiduciary funds. The amendment requires that substantially all Pennsylvania attorneys place all fiduciary funds they handle in interest-bearing accounts and that the interest earned inure to the benefit of clients, qualifying third parties, or is given to the IOLTA program. Effective September 1, 1996, the Pennsylvania Interest on Lawyers Trust Account Board (the Board) was established to administer this program through a nine member Board, all of whom are appointed by the Supreme Court.

Reporting Entity

The Board's financial statements present the financial position and results of operations of the Board only. The Board does not exercise oversight responsibility for any other organization. It is a component unit of the judicial branch of the Commonwealth of Pennsylvania.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The financial statements of the Board are prepared in accordance with generally accepted accounting principles. The Board applies all relevant Governmental Accounting Standards Board (GASB) pronouncements and applicable Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless they conflict with GASB pronouncements. The Board does not apply FASB pronouncements issued after November 30, 1989.

The Board's financial statements report using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of the timing of related cash flows.

Restricted Disclosure

When both restricted and unrestricted resources are available for use, it is the Board's policy to use restricted resources first, then unrestricted resources as they are needed.

Estimates

The preparation of financial statements under the accrual basis of accounting requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

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PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Grants

The amendment to the Pennsylvania Rules of Professional Conduct requires that IOLTA interest be used for the following purposes; (1) delivery of civil legal assistance to the poor and disadvantaged in Pennsylvania by non-profit corporations described in Section 501(c)(3) of the Internal Revenue Code; (2) educational legal clinical programs and internships administered by law schools located in Pennsylvania; (3) administration and development of the IOLTA program in Pennsylvania; and (4) the administration of justice in Pennsylvania. Grants are generally awarded on an annual basis and grant payments are disbursed on a semi-annual or quarterly basis. Grants are expensed at the inception of the specified grant period.

Capital Assets

Capital assets consisting of furniture, equipment, computer software, and leasehold improvements are recorded at cost. Depreciation policies reflect the use of the straight-line method with useful lives of three and five years. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to income as incurred; significant renewals and betterments are capitalized. Deductions are made for retirements resulting from the renewals or betterments.

Net Assets

Net assets are classified in the following three components: invested in capital assets; restricted and unrestricted. Invested in capital assets consists of all capital assets, net of accumulated depreciation. Restricted consists of net assets for which constraints are placed thereon by regulations and enabling legislation, less any related liabilities.

Risk Management

The Board is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. Significant losses are covered by commercial insurance. There were no significant reductions in insurance coverage in fiscal year 2004. There were no significant claims in the current year or the two prior years.

Tax Status

The Board is exempt from Federal income taxes under Section 501(c)(3) of the Internal Revenue Service Code and from Commonwealth of Pennsylvania corporate taxes.

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PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Changes in Accounting Principles

For the year ended June 30, 2003, the Board implemented *GASB Statement No. 34, Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, as amended by *GASB Statement No. 37, Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus—an amendment of GASB Statements No. 21 and No. 34*, and *GASB Statement No. 38, Certain Financial Statement Disclosures*.

GASB Statement No. 34 creates new financial statement formats for the Board's financial activities and requires management's discussion and analysis. GASB Statement No. 37 clarifies certain provisions of Statement No. 34, including the required content of management's discussion and analysis. GASB Statement No. 38 modifies, establishes and rescinds certain financial statement note disclosures. The implementation of these changes had no effect on the Board's total fund equity as it was previously reported.

2. CASH

Under statute, the Board's deposits must be held in insured depositories. The Board may also invest in direct obligations of the U.S. Government and agencies thereof. The Board follows the policy of depositing cash and cash equivalents in demand deposit and money market accounts of Pennsylvania financial institutions.

The cash of the Board at June 30, 2004 and 2003 have been categorized to indicate the level of credit risk assumed by the Board. Category 1 includes deposits that are insured or collateralized with securities held by the Board or the Board's agent in the Board's name. Category 2 includes deposits which are collateralized with securities held by the pledging financial institution's trust department or agent in the Board's name. Category 3 includes deposits which are uncollateralized or collateralized with securities held by the pledging financial institution, or by its trust department or agent but not in the Board's name.

At June 30, 2004, the Board had Category 1 cash with a carrying value of \$100,000 and a bank balance of \$100,000. The Board also had Category 3 cash and cash equivalents with a carrying value of \$1,621,716 and a bank balance of \$1,636,404.

At June 30, 2003, the Board had Category 1 cash with a carrying value of \$100,000 and a bank balance of \$100,000. The Board also had Category 3 cash and cash equivalents with a carrying value of \$445,252 and a bank balance of \$467,444.

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PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

NOTES TO FINANCIAL STATEMENTS

3. CAPITAL ASSETS

Capital assets activity for the year ended June 30, 2004 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets				
Furniture	\$ 64,351	\$ 11,719	\$ -	\$ 76,070
Software	36,959	2,194	-	39,153
Leasehold improvements	4,199	-	-	4,199
Total capital assets	<u>105,509</u>	<u>13,913</u>	<u>-</u>	<u>119,422</u>
Less accumulated depreciation for:				
Furniture	(51,611)	(5,610)	-	(57,221)
Software	(36,598)	(2,333)	-	(38,931)
Leasehold improvements	(4,199)	-	-	(4,199)
Total accumulated depreciation	<u>(92,408)</u>	<u>(7,943)</u>	<u>-</u>	<u>(100,351)</u>
Capital assets, net	<u>\$ 13,101</u>	<u>\$ 5,970</u>	<u>\$ -</u>	<u>\$ 19,071</u>

Capital assets activity for the year ended June 30, 2003 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets				
Furniture	\$ 65,244	\$ 4,420	\$ (5,313)	\$ 64,351
Software	37,945	-	(986)	36,959
Leasehold improvements	4,199	-	-	4,199
Total capital assets	<u>107,388</u>	<u>4,420</u>	<u>(6,299)</u>	<u>105,509</u>
Less accumulated depreciation for:				
Furniture	(47,876)	(9,048)	5,313	(51,611)
Software	(36,720)	(864)	986	(36,598)
Leasehold improvements	(4,199)	-	-	(4,199)
Total accumulated depreciation	<u>(88,795)</u>	<u>(9,912)</u>	<u>6,299</u>	<u>(92,408)</u>
Capital assets, net	<u>\$ 18,593</u>	<u>\$ (5,492)</u>	<u>\$ -</u>	<u>\$ 13,101</u>

Depreciation expense for the years ended June 30, 2004 and 2003 was \$7,943 and \$9,912.

(continued)

PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

NOTES TO FINANCIAL STATEMENTS

4. IOLTA REVENUES AND GRANT EXPENSES

Lawyers throughout Pennsylvania have established special interest-bearing IOLTA accounts with their local depository institutions for funds received by the lawyers in a fiduciary capacity which can not practically be invested to benefit the owner of the funds. The depository institutions transfer IOLTA interest earnings, net of service charges, to the Board. The Board uses these funds to make grants to not-for-profit corporations which operate in Pennsylvania, whose primary purpose is to provide civil legal services without charge to eligible clients. The Board can also provide grants to law schools in Pennsylvania for educational legal clinical programs and internships, and administration of justice. All of the Board's grants are directed to the provision of civil legal services for the poor and disadvantaged. Total grants awarded by the Board during the years ended June 30, 2004 and 2003, net of rescissions, amounted to \$6,867,279 and \$7,103,596.

During March 2004, the Board recommended, and the Supreme Court of Pennsylvania approved, \$8,500,256 in grants for the grant year July 1, 2004 through June 30, 2005.

5. ACCESS TO JUSTICE REVENUE AND GRANT EXPENSES

With the passage of Act 122 in 2002, an additional fee of \$10, starting November 1, 2002, was authorized to be charged and collected by prothonotaries, clerks of courts, clerks of orphans' courts, registers of wills, recorders of deeds, and the minor judiciary including district justices, Philadelphia Municipal Court, Philadelphia Traffic Court, and Pittsburgh Magistrates Court, on certain civil and criminal courthouse filings. In criminal matters the additional fee is collected if a conviction is obtained or a guilty plea is entered. Proceeds from the additional fees are transferred by the collecting authority to the Pennsylvania Department of Revenue for deposit into either the Judicial Computer System Augmentation Account (JCSAA) or the Access to Justice Account (AJA). The split of the collections between the two accounts is as follows:

<u>Fiscal Years Ending June 30:</u>	<u>JCSAA</u>	<u>AJA</u>
2003	90%	10%
2004	85%	15%
2005	85%	15%
2006, and thereafter	80%	20%

The AJA is scheduled to sunset on November 1, 2007. Funds in the AJA are distributed annually to the Pennsylvania Interest on Lawyers Trust Account Board for the provision of civil legal assistance for the Commonwealth's poor. The Board earned collections totaling \$7,659,679 and \$2,942,829 relating to the AJA during the years ended June 30, 2004 and 2003, of which \$7,510,327 and \$2,237,444 was available for appropriation for the 2005 and 2004 fiscal years.

(continued)

PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

NOTES TO FINANCIAL STATEMENTS

5. ACCESS TO JUSTICE REVENUE AND GRANT EXPENSES (Cont'd)

During March 2004, the Board recommended, and the Supreme Court of Pennsylvania approved, \$6,984,500 in grants to Pennsylvania Legal Services for the grant period July 1, 2004 through June 30, 2005.

6. PRO BONO INITIATIVE CONTRIBUTIONS AND GRANT EXPENSES

In June 2001, the Chief Justice of the Supreme Court of Pennsylvania asked lawyers licensed to practice law in Pennsylvania to voluntarily contribute at least \$50 each to help fund the infrastructure necessary for organized county-based pro bono programs. The Board received contributions totaling \$64,683 and \$45,346 as a result of the appeal during the years ended June 30, 2004 and 2003. Grants to pro bono programs (included in amounts in note 4) by the Board totaled \$17,151 and \$97,735 during the years June 30, 2004 and 2003.

During March 2004, the Board recommended and the Supreme Court of Pennsylvania approved \$54,700 in Pro Bono grants for the grant period July 1, 2004 through June 30, 2005.

7. LAWYER FUND FOR CLIENT SECURITY

In 2004, the Supreme Court of Pennsylvania authorized a one-time transfer of \$1,400,000 to the Board from the Lawyer Fund for Client Security, a separate organization, also operated under the jurisdiction of the court. The intended use of the revenue is for payment of the law school grants for the fiscal year July 1, 2004 to June 30, 2005.

8. LEASES

The Board leases office space in Harrisburg under a two year operating lease. Lease expense for the year ended June 30, 2004 and 2003, amounted to \$21,328 and \$21,328. Minimum amounts payable under the lease of \$21,328 and \$17,777 are due for the years ending June 30, 2005 and 2006.

(continued)

PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

NOTES TO FINANCIAL STATEMENTS

9. RETIREMENT PLAN

The Board sponsors a 403(b) retirement plan. There were employer contributions of \$29,441 and \$34,281 to the plan for the year ended June 30, 2004 and 2003.

10. DEFERRED COMPENSATION PLAN

During the year ended June 30, 2004, the Board entered into a deferred compensation agreement with the Executive Director. The deferred compensation is to be paid to the Executive Director or his heirs in three substantially equal annual installments an amount equal to the fair market value of the assets in the Rabbi Trust as of that date. The Board accrued \$5,000 to the plan as of June 30, 2004.

SUPPLEMENTARY INFORMATION

PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

DETAILED SCHEDULE OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

YEARS ENDED JUNE 30, 2004
(WITH COMPARATIVE TOTALS FOR 2003)

	<u>General</u>	<u>Access to Justice</u>	<u>Pro Bono Initiative</u>	<u>Property</u>	<u>Total 2004</u>	<u>Total 2003</u>
Operating revenues						
IOLTA interest, net of service charges of \$229,563 and \$240,315	\$ 4,741,212	\$ -	\$ -	\$ -	\$ 4,741,212	\$ 5,879,267
Access to Justice fees	-	7,659,679	-	-	7,659,679	2,942,829
Total operating revenues	<u>4,741,212</u>	<u>7,659,679</u>	<u>-</u>	<u>-</u>	<u>12,400,891</u>	<u>8,822,096</u>
Operating expenses						
Program administration	323,649	78,659	-	7,943	410,251	464,017
Grant awards						
Legal service organizations	3,865,571	2,140,444	-	-	6,006,015	5,356,000
Law schools	844,113	-	-	-	844,113	1,649,861
Pro bono grants	-	-	17,151	-	17,151	97,735
Total grant awards	<u>4,709,684</u>	<u>2,140,444</u>	<u>17,151</u>	<u>-</u>	<u>6,867,279</u>	<u>7,103,596</u>
Total operating expenses	<u>5,033,333</u>	<u>2,219,103</u>	<u>17,151</u>	<u>7,943</u>	<u>7,277,530</u>	<u>7,567,613</u>
Operating income (loss)	<u>(292,121)</u>	<u>5,440,576</u>	<u>(17,151)</u>	<u>(7,943)</u>	<u>5,123,361</u>	<u>1,254,483</u>
Non-operating revenues						
Contributions						
Pro Bono Initiative	-	-	64,683	-	64,683	45,752
Lawyer Fund for Client Security	1,400,000	-	-	-	1,400,000	-
Interest and service charges	(2,049)	5,557	-	-	3,508	8,794
Total non-operating revenues	<u>1,397,951</u>	<u>5,557</u>	<u>64,683</u>	<u>-</u>	<u>1,468,191</u>	<u>54,546</u>
Change in net assets	1,105,830	5,446,133	47,532	(7,943)	6,591,552	1,309,029
Reclassification of net assets						
Acquisition of property	(11,688)	(2,226)	-	13,914	-	-
Net assets - July 1	<u>897,104</u>	<u>2,927,768</u>	<u>59,572</u>	<u>13,101</u>	<u>3,897,545</u>	<u>2,588,516</u>
Net assets - June 30	<u>\$ 1,991,246</u>	<u>\$ 8,371,675</u>	<u>\$ 107,104</u>	<u>\$ 19,072</u>	<u>\$10,489,097</u>	<u>\$ 3,897,545</u>

PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

SCHEDULE OF PROGRAM ADMINISTRATION EXPENSES AND PROPERTY ACQUISITIONS - BUDGET AND ACTUAL

YEARS ENDED JUNE 30, 2004

	Budget (Unaudited)	General	Access to Justice	Property
Program administration expenses				
Personnel				
Wages	\$ 215,075	\$ 164,447	\$ 43,895	\$ -
Fringe benefits	87,825	59,385	15,371	-
Total personnel	<u>302,900</u>	<u>223,832</u>	<u>59,266</u>	<u>-</u>
Operating				
Advertising	1,000	-	-	-
Consultants and contract services	44,000	40,246	7,666	-
Office supplies	8,000	4,965	946	-
Postage	3,000	2,279	434	-
Printing and publications	8,500	6,712	1,658	-
Rent	25,000	17,916	3,412	-
Telephone	5,500	2,680	511	-
Temporary help	600	503	96	-
Travel - staff and board	14,000	13,069	2,490	-
Depreciation	12,000	-	-	7,943
Insurance	5,500	5,562	1,059	-
Equipment maintenance	14,000	5,065	965	-
Other	1,000	820	156	-
Total operations	<u>142,100</u>	<u>99,817</u>	<u>19,393</u>	<u>7,943</u>
Total program administration expenses	<u>\$ 445,000</u>	<u>\$ 323,649</u>	<u>\$ 78,659</u>	<u>\$ 7,943</u>
Property acquisitions				
Equipment and software purchased	<u>\$ 40,000</u>	<u>\$ 11,688</u>	<u>\$ 2,226</u>	<u>\$ -</u>

PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

SCHEDULES OF GRANT RECIPIENTS

YEARS ENDED JUNE 30, 2004 AND 2003

	<u>2004</u>	<u>2003</u>
Legal service organizations		
Aids Law Project	\$ 15,500	\$ 13,200
Allegheny County Bar Foundation	40,000	39,000
Allegheny County CASA Program	20,000	19,000
Allegheny County Mental Health Services	-	15,000
Commonwealth Advocacy Project	-	25,000
Community Legal Services	35,000	33,000
Consumer Bankruptcy Assistance Project	22,000	20,000
Disabilities Law Project	20,000	17,600
Education Law Center	20,000	17,600
Friends of Farmworkers	170,000	162,200
HIAS & Council Migration Services of Philadelphia	15,000	13,000
Homeless Advocacy Project	12,000	10,000
Juvenile Law Project	20,000	14,900
Lackawanna Pro Bono, Inc.	15,000	12,000
Legal Aid of Southeast PA	70,400	34,000
Legal Aid Society of Pittsburgh	35,000	49,000
Legal Clinic for the Disabled	19,000	19,000
Legal Services of Southwestern PA	60,000	58,000
Lewisburg Prison Project	26,600	25,700
MidPenn Legal Services	45,000	37,300
North Penn Legal Services	50,400	81,000
Northwestern Legal Services	27,700	23,000
PA Health Law Project	38,000	35,200
PA Immigration Resource Center	25,000	25,000
Pennsylvania Legal Services	5,010,915	4,390,000
Philadelphia Legal Assistance	8,500	5,000
Philadelphia Volunteer Lawyers for the Arts	7,000	5,000
Philadelphia Volunteers for the Indigent Program	45,000	37,000
Protection from Abuse Coordinated Services, Inc.	20,000	20,000
Public Interest Law Center of Philadelphia	18,000	15,000
Regional Housing Legal Services	12,000	11,300
Senior Citizens Judicare	18,000	15,500
Support Center Child Advocates	35,000	32,000
Westmoreland Bar Foundation	20,000	19,000
Women Against Abuse Legal Center	10,000	7,500
	<hr/>	<hr/>
Total legal service organizations	6,006,015	5,356,000

(continued)

PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

SCHEDULES OF GRANT RECIPIENTS (Cont'd)

YEARS ENDED JUNE 30, 2004 AND 2003

	<u>2004</u>	<u>2003</u>
Law schools		
Pennsylvania State University - Dickinson School of Law	172,506	191,827
Duquesne University	111,930	250,000
Temple University	111,930	250,000
University of Pennsylvania	111,930	250,000
University of Pittsburgh	111,930	250,000
Villanova University	111,930	250,000
Widener University	111,957	208,034
	<u>844,113</u>	<u>1,649,861</u>
Total law schools		
Pro bono grants		
Bedford County Bar Association	(9,000)	9,000
Lackawanna Pro Bono, Inc.	4,500	4,125
Laurel Legal Services	-	15,000
Legal Aid of Luzerne County	10,651	39,610
Legal Aid of Southeastern PA	-	20,000
Warren Bar Association	6,000	
Washington County Bar Association	-	
Wyoming Bar Association	5,000	10,000
	<u>17,151</u>	<u>97,735</u>
Total pro bono grants		
Total grant awards	<u>\$ 6,867,279</u>	<u>\$ 7,103,596</u>