

**PENNSYLVANIA INTEREST ON  
LAWYERS TRUST ACCOUNT BOARD  
FINANCIAL STATEMENTS  
FOR THE YEARS ENDED  
JUNE 30, 2006 AND 2005  
AND  
INDEPENDENT AUDITOR'S REPORT**

**HAMILTON & MUSSER, P.C.**  
*Certified Public Accountants*

**PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD**

Table of Contents

For the Years Ended June 30, 2006 and 2005

<b><u>CONTENTS</u></b>	<b><u>PAGE</u></b>
Independent Auditor's Report	1
Management's Discussion and Analysis	2-7
Financial Statements:	
Balance Sheets	8
Statements of Revenue, Expenses, and Changes in Net Assets	9
Statements of Cash Flows	10
Notes to Financial Statements	11-15
Supplementary Information:	
Detailed Schedule of Revenue, Expenses, and Changes in Net Assets	16
Schedule of Program Administration Expenses and Property Acquisitions – Budget & Actual	17
Schedules of Grant Recipients	18-19



# HAMILTON & MUSSER, P.C.

*Certified Public Accountants • Consultants to Management*

DAVID A. HAMILTON, CPA  
BARRY E. MUSSER, CPA, CFP®

JAMES A. KRIMMEL, MBA, CPA, CFE  
ROBERT D. MAST, CPA

## INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying balance sheet of the Pennsylvania Interest on Lawyers Trust Account Board, a component unit of the Supreme Court of the Commonwealth of Pennsylvania, as of and for the year ended June 30, 2006, and the related statement of revenue, expenses and changes in net assets, and cash flows for the year then ended. 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 audit. The financial statements of the Pennsylvania Interest on Lawyers Trust Account Board as of June 30, 2005 were audited by other auditors. Those auditors expressed an unqualified opinion on those financial statements in their report dated August 23, 2005.

We conducted our audit 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 audit and the report of the other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the report of other auditors, 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, 2006 and 2005, 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 2 through 7 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 16 through 19 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.

August 10, 2006

Mechanicsburg, Pennsylvania

*Certified Public Accountants*

*Members of the American and Pennsylvania Institutes of CPA's*

## PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

### Management's Discussion and Analysis For the Years Ended June 30, 2006 and 2005

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, 2006 with selected comparative information for the fiscal year ending June 30, 2005. 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 eligible 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 1.15. 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 low-income 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 1.15, 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 fiscal year ending June 30, 2006, \$10.1 million and for the fiscal year ending June 30, 2005 \$7.5 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, 2012 under a sunset provision of the statute.

Effective February 1, 2005, the Supreme Court of Pennsylvania required judicial officials of the Minor Judiciary to establish IOLTA-like accounts for their custodial accounts. The program is referred to as the Minor Judiciary Interest on Trust Accounts (MJ-IOTA) program. The MJ-IOTA program is similar to the IOLTA program. Judicial officials maintain custodial accounts to hold the collection of fees and fines, collateral and cash bonds, restitution for victims of crime and other similar amounts, until the funds are ultimately transferred to the owners. Essentially, all of the funds handled by the minor judiciary are qualified funds, that is, funds which are nominal in amount or will be held for a short period of time.

The IOLTA Board also receives some limited funding from voluntary lawyer contributions. Each year lawyers must 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 for indigent Pennsylvania residents by lawyers in private practice. Pro bono representation is the provision of legal assistance for the public good by lawyers without the expectation of a fee for the services.

The Accompanying Notes are an Integral Part of the Financial Statements

# PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

Management's Discussion and Analysis  
For the Years Ended June 30, 2006 and 2005

## IOLTA BOARD'S ACTIVITY HIGHLIGHTS

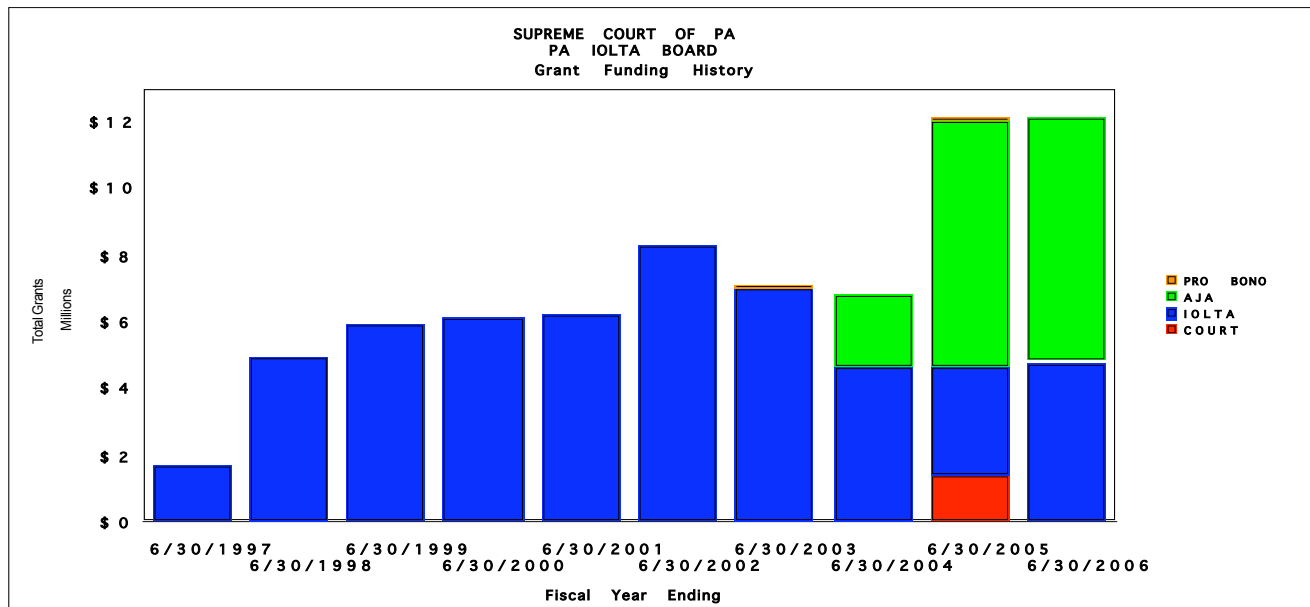
National and other studies have concluded that only one of five indigent persons needing civil legal assistance actually receives the needed legal help. As a result, legal assistance is often rationed to those whose needs are determined the greatest, such as victims of domestic violence, tenants and 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 monitors lawyer compliance with the IOLTA requirements of RPC 1.15.

### Overall Grant Activities

Since the inception of the IOLTA Board in Pennsylvania through June 30, 2006, about \$87.5 million of grants have been awarded (nearly \$71.8 of which were awarded while the IOLTA Board 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, while the IOLTA Board was under the jurisdiction of the Supreme Court, grants have generally increased over the years.

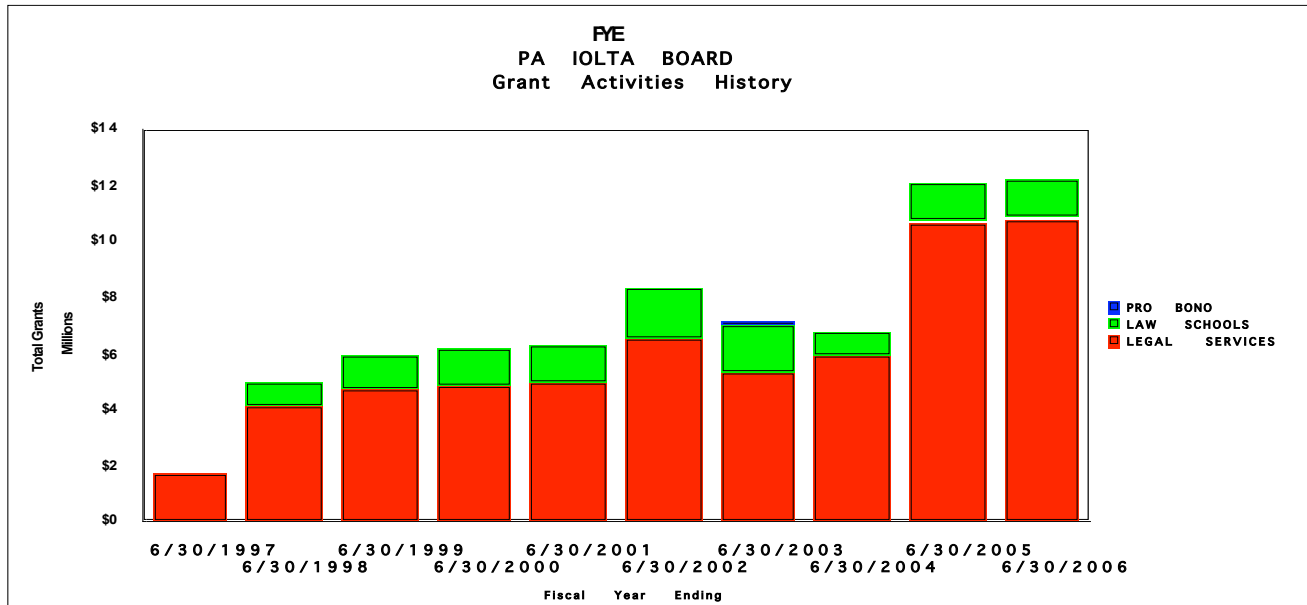


Since the IOLTA Board came under the jurisdiction of the Supreme Court of PA, most grants, \$59.8 million, have gone to legal services organizations, almost \$11.8 million to law school clinical and externship programs, and about \$228,000 to establish or expand pro bono efforts.

The Accompanying Notes are an Integral Part of the Financial Statements

**PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD**

Management's Discussion and Analysis  
For the Years Ended June 30, 2006 and 2005



Previously, the IOLTA Board, by policy, stabilized the annual grant levels to the law schools at \$200,000 each, or \$1.4 million annually. During the past year, the IOLTA Board considered a policy to stabilize grant to legal services organizations that receive IOLTA grant funds.

IOLTA revenues are significantly influenced by changing interest rates and the general health of the economy, factors which tend to be cyclical. Accordingly, the Board considered the option of awarding grants to legal services organizations based on an average level of IOLTA revenues. In this way the organizations that presumptively receive grant funding could better plan a relatively stabilized level of grants. The option would require that the IOLTA Board hold a larger cash reserve than it had previously to allow it to finance the average grant level in years when the actual annual level of IOLTA revenue would not be sufficient. Grantee organizations that would be most affected by this policy urged the IOLTA Board to award IOLTA grant funds as they are available rather than accumulate a cash reserve for the purpose of stabilizing the grants.

The grantee organizations preferred that they self-finance the variability of IOLTA funded grants. As a result, the IOLTA Board decided to establish a cash reserve that would be sufficient (to a high degree of certainty) to finance the annual level of IOLTA grants it awards, and not provide a stabilized level of IOLTA funding for legal services organizations.

***Revenue Enhancement***

In April 2005, the Supreme Court of Pennsylvania amended RPC 1.15 which contains the underlying authority for the attorney IOLTA program. Included in the amended rule is the following requirement:

“The rate of interest payable on an IOLTA account shall not be less than the highest rate or dividend generally available from the financial institution to its non-IOLTA account customers when the IOLTA account meets or exceeds the same minimum balance and other account eligibility qualifications applicable to those other accounts.”

The Accompanying Notes are an Integral Part of the Financial Statements

## PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

Management's Discussion and Analysis  
For the Years Ended June 30, 2006 and 2005

This action is similar to that of other states and is the same as the requirement for the MJ-IOTA program. Representatives of the IOLTA Board and financial institutions have been meeting to determine how to best implement the requirement. However, in response to requests for better yields on IOLTA and MJ-IOTA accounts, leading financial institutions have taken steps to pay comparable interest rates on the accounts immediately resulting in increased IOLTA and MJ-IOTA revenues.

### *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 escrow 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 also 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.

### COMMENTS ON FINANCIAL STATEMENTS

Condensed financial data extracted from the basic financial statements for the fiscal years ended June 30, 2006 and 2005 is as follows:

	<u>2006</u>	<u>2005</u>
Capital assets	\$ 7,560	\$ 10,187
Other assets	<u>19,764,718</u>	<u>11,859,158</u>
Total assets	<u>\$ 19,772,278</u>	<u>\$ 11,869,345</u>
Total current liabilities	<u>\$ 109,792</u>	<u>\$ 69,624</u>
Invested in capital assets	7,560	10,187
Restricted net assets	11,361,637	11,649,953
Unrestricted net assets	<u>8,293,289</u>	<u>139,581</u>
Total net assets	<u>19,662,486</u>	<u>11,799,721</u>
Total liabilities and net assets	<u>\$ 19,772,278</u>	<u>\$ 11,869,345</u>
IOLTA interest, net of service charges	\$ 10,132,675	\$ 6,233,446
Access to Justice fees	<u>10,112,786</u>	<u>7,488,907</u>
Total operating revenues	<u>20,245,461</u>	<u>13,722,353</u>
Program administration	<u>507,254</u>	<u>460,775</u>
Grant awards		
Legal service organizations	10,790,131	10,676,994
Law schools	1,369,584	1,400,000
Pro bono grants	<u>58,608</u>	<u>54,700</u>
Total grant awards	<u>12,218,323</u>	<u>12,131,694</u>
Total operating expenses	<u>12,725,577</u>	<u>12,592,469</u>
Total non-operating revenues	<u>342,881</u>	<u>180,740</u>
Change in net assets	7,862,765	1,310,624
Net assets – July 1	<u>11,799,721</u>	<u>10,489,097</u>
Net assets – June 30	<u>\$ 19,662,486</u>	<u>\$ 11,799,721</u>

The Accompanying Notes are an Integral Part of the Financial Statements

**PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD**

Management's Discussion and Analysis  
For the Years Ended June 30, 2006 and 2005

***IOLTA Interest***

As between the reported years, IOLTA interest has increased over \$5.4 million. Interest on IOLTA and MJ-IOTA accounts is dependent upon interest rates, service charges, principal balances, and attorney participation. Most of this increase is attributable to the higher interest rates which financial institutions have been paying (see *Revenue Enhancement*) in response to the request for comparable interest rates for IOLTA and MJ-IOTA accounts.

As a result of the increased IOLTA revenues, cash and the interest receivable from financial institutions at fiscal year end has increased substantially, as has the IOLTA (and MJ-IOTA) net assets.

***Other Assets***

In addition to the increased IOLTA cash and receivable from the financial institutions, the receivable from the Commonwealth of Pennsylvania for the Access to Justice Act collections increased nearly \$2.7 million. When the AJA was enacted, it provided for a phase-in of the collections authorized by Act 122 of 2002 increasing from 10% to 20% over four years. During the fiscal year ending June 30, 2006 the phase-in was completed with the allocation of the collections increasing from 15% to 20% (see Note 5).

***Legal Services Organization Grants***

Grants totaling \$10,790,130 and \$10,676,994 were awarded in fiscal years ended June 30, 2006 and 2005 to thirty-two and thirty-four non-profit organizations respectively that facilitate and/or provide civil legal assistance to the indigent and disadvantaged residents of Pennsylvania. The largest grant this past year, over \$9.3 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 in over 27,400 cases for indigent persons in all sixty-seven counties in Pennsylvania.

Direct grants were made to some of the organizations of the Pennsylvania Legal Aid Network 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 a toll-free number that callers from the area served by the program can use to seek legal assistance. After financial eligibility for service 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 and paralegals staffing the telephone help line. Other grants were awarded to help remove 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 amongst 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 \$1,369,584 and \$1,400,000 in fiscal years ended June 30, 2006 and 2005. Each school received at least a \$200,000 grant. Fifteen clinics operated by the law schools received IOLTA grant support. On average, the IOLTA grant for a clinic usually provides about 50% 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. The law students and faculty planned to spend about 43,300 hours in the direct representation of indigent or eligible clients in the fiscal year ending June 30, 2006.

The Accompanying Notes are an Integral Part of the Financial Statements

**PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD**

Management's Discussion and Analysis  
For the Years Ended June 30, 2006 and 2005

***Pro Bono Initiative***

This year organized pro bono programs were funded in six counties and one statewide effort at the level of \$58,608. The grants were expected to help mobilize 1,078 lawyer volunteers to provide civil legal assistance for the indigent.

The Accompanying Notes are an Integral Part of the Financial Statements

**PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD**

Balance Sheets  
June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
<b>Current Assets</b>		
Cash and Cash Equivalents	\$ 7,637,521	\$ 2,739,822
Investments	18,578	10,693
Accounts Receivable		
IOLTA Interest	1,068,576	752,582
Access to Justice	11,013,786	8,343,644
Other	16,501	2,222
Prepaid Expenses	<u>9,756</u>	<u>10,195</u>
Total Current Assets	<u>19,764,718</u>	<u>11,859,158</u>
Capital Assets (Note 3)	95,739	96,482
Less – Accumulated Depreciation (Note 3)	<u>(88,179)</u>	<u>(86,295)</u>
Total Capital Assets	<u>7,560</u>	<u>10,187</u>
Total Assets	<u>\$ 19,772,278</u>	<u>\$ 11,869,345</u>
<b>Current Liabilities</b>		
Accounts Payable		
Legal Service Organizations	\$ -	\$ 2,500
Other	21,180	35,320
Accrued Expenses	<u>88,612</u>	<u>31,804</u>
Total Current Liabilities	<u>109,792</u>	<u>69,624</u>
<b>Net Assets</b>		
Unrestricted to IOLTA Program	8,294,134	3,216,851
Invested in Capital Assets	7,560	10,187
Restricted to Access to Justice Program	11,213,615	8,433,102
Restricted to Pro Bono Initiative	<u>147,177</u>	<u>139,581</u>
Total Net Assets	<u>19,662,486</u>	<u>11,799,721</u>
Total Liabilities and Net Assets	<u>\$ 19,772,278</u>	<u>\$ 11,869,345</u>

The Accompanying Notes are an Integral Part of the Financial Statements

**PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD**

Statements of Revenue, Expenses, and Changes in Net Assets

For the Years Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Operating Revenue		
IOLTA Interest, Net of Service Charges of \$304,879 and \$262,184	\$ 10,132,675	\$ 6,233,446
Access to Justice Fees	<u>10,112,786</u>	<u>7,488,907</u>
Total Operating Revenue	<u>20,245,461</u>	<u>13,722,353</u>
Operating Expenses		
Program Administration	<u>507,254</u>	<u>460,775</u>
Grant Awards		
Legal Service Organizations	10,790,131	10,676,994
Law Schools	1,369,584	1,400,000
Pro Bono Grants	<u>58,608</u>	<u>54,700</u>
Total Grant Awards	<u>12,218,323</u>	<u>12,131,694</u>
Total Operating Expenses	<u>12,725,577</u>	<u>12,592,469</u>
Operating Income	<u>7,519,884</u>	<u>1,129,884</u>
Non-Operating Revenue		
Contributions		
Pro Bono Initiative	66,204	87,177
Other Interest and Service Charges, Net	<u>276,677</u>	<u>93,563</u>
Total Non-Operating Revenue	<u>342,881</u>	<u>180,740</u>
Change in Net Assets	7,862,765	1,310,624
Net Assets, Beginning of Year	<u>11,799,721</u>	<u>10,489,097</u>
Net Assets, End of Year	<u>\$ 19,662,486</u>	<u>\$ 11,799,721</u>

The Accompanying Notes are an Integral Part of the Financial Statements

**PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD**

Statements of Cash Flows

For the Years Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Cash Flows from Operating Activities		
IOLTA Interest Received	\$ 9,816,681	\$ 5,960,864
Access to Justice Fees Received	7,442,644	7,510,327
Other Cash Receipts	(14,279)	40,119
Cash Paid to Grant Recipients	(12,220,823)	(12,235,809)
Cash Paid to Suppliers	(158,900)	(106,869)
Cash Paid to Employees	(301,713)	(305,264)
Other Cash Payments	<u>3,319</u>	<u>(18,179)</u>
Net Cash and Cash Equivalents Provided by Operating Activities	<u>4,566,929</u>	<u>845,189</u>
Cash Flows from Non-Capital Financing Activities		
Contributions		
Pro Bono Initiative	<u>66,204</u>	<u>87,177</u>
Net Cash and Cash Equivalents Provided by Non-Capital Financing Activities	<u>66,204</u>	<u>87,177</u>
Cash Flows from Capital and Related Financing Activities		
Acquisitions of Capital Assets	<u>(4,226)</u>	<u>(2,822)</u>
Net Cash, and Cash Equivalents (Used) by Capital and Related Financing Activities	<u>(4,226)</u>	<u>(2,822)</u>
Cash Flows from Investing Activities		
Purchase of Investments	(7,885)	(5,000)
Interest	<u>276,677</u>	<u>93,562</u>
Net Cash, and Cash Equivalents Provided (Used) by Investing Activities	<u>268,792</u>	<u>88,562</u>
Increase in Cash and Cash Equivalents	4,897,699	1,018,106
Cash and Cash Equivalents, Beginning of Year	<u>2,739,822</u>	<u>1,721,716</u>
Cash and Cash Equivalents, End of Year	<u>\$ 7,637,521</u>	<u>\$ 2,739,822</u>
Reconciliation of Operating Income to		
Net Cash and Cash Equivalents Provided by Operating Activities		
Operating Income	\$ 7,519,884	\$ 1,129,884
Adjustments to Reconcile Operating Income to Net Cash and Cash Equivalents Provided by Operating Activities		
Depreciation Expense	6,853	11,707
Changes in Assets and Liabilities:		
Accounts Receivable	(3,000,415)	(211,043)
Prepaid Expenses	439	(1,910)
Accounts Payable	(16,640)	(84,292)
Accrued Expenses	<u>56,808</u>	<u>843</u>
Net Cash and Cash Equivalents Provided by Operating Activities	<u>\$ 4,566,929</u>	<u>\$ 845,189</u>

The Accompanying Notes are an Integral Part of the Financial Statements

## PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD

Notes to Financial Statements

For the Years Ended June 30, 2006 and 2005

### NOTE 1 NATURE OF ACTIVITIES AND 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 uses the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of the timing of related cash flows.

#### **Restricted Resources:**

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.

#### **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.

**PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD**

Notes to Financial Statements  
For the Years Ended June 30, 2006 and 2005

**NOTE 1 NATURE OF ACTIVITIES AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**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. Unrestricted consists of the net assets of the Board, which are not restricted for any project or other purpose.

**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 2006. 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.

**NOTE 2 CASH AND CASH EQUIVALENTS AND INVESTMENTS**

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 holding cash deposits in demand deposit and money market accounts of Pennsylvania financial institutions.

***Custodial Credit Risk – Deposits***

Custodial credit risk is the risk that in the event of a bank failure, the Board's deposits may not be returned to it. As of June 30, 2006, \$7,194,012 of the Board's bank balances of \$7,294,012 was exposed to custodial credit risk as follows:

Uninsured and Collateral Held by Pledging Bank's Trust Department not in the Board's Name	<u>\$ 7,194,012</u>
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As of June 30, 2005, \$2,349,119 of the Board's bank balances of \$2,449,119 was exposed to custodial credit risk as follows:

Uninsured and Collateral Held by Pledging Bank's Trust Department not in the Board's Name	<u>\$ 2,349,119</u>
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**PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD**

Notes to Financial Statements

For the Years Ended June 30, 2006 and 2005

**NOTE 3 CAPITAL ASSETS**

Capital assets activity for the year ended June 20, 2006 was as follows:

Capital Assets	
Furniture and Equipment	\$ 56,131
Software	35,409
Leasehold Improvements	<u>4,199</u>
Total Capital Assets	95,739
Less: Accumulated Depreciation for	
Furniture and Equipment	(47,731)
Software	(36,249)
Leasehold Improvements	<u>(4,199)</u>
Total Accumulated Depreciation	<u>(88,179)</u>
Capital Assets, Net	<u>\$ 7,560</u>

Capital assets activity for the year ended June 20, 2005 was as follows:

Capital Assets	
Furniture and Equipment	\$ 56,874
Software	35,409
Leasehold Improvements	<u>4,199</u>
Total Capital Assets	96,482
Less: Accumulated Depreciation for	
Furniture and Equipment	(45,847)
Software	(36,249)
Leasehold Improvements	<u>(4,199)</u>
Total Accumulated Depreciation	<u>(86,295)</u>
Capital Assets, Net	<u>\$ 10,107</u>

Depreciation expense of \$6,853 and \$11,707 was recorded for the years ended June 30, 2006 and 2005, respectively.

**NOTE 4 IOLTA REVENUE 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, 2006 and 2005, net of rescissions, amounted to \$12,218,323 and \$12,131,694, respectively.

**PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD**

Notes to Financial Statements

For the Years Ended June 30, 2006 and 2005

**NOTE 4 IOLTA REVENUE AND GRANT EXPENSES (CONTINUED)**

During March 2006, the Board recommended, and the Supreme Court of Pennsylvania approved, \$20,252,796 in grants for the grant year July 1, 2006 through June 30, 2007.

**NOTE 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>
2004	85%	15%
2005	85%	15%
2006	80%	20%
2007 and Thereafter	80%	20%

The AJA is scheduled to sunset on November 1, 2012. 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 \$10,112,786 and \$7,488,909 relating to the AJA during the years ended June 30, 2006 and 2005, of which \$9,866,883 and \$7,442,644 was available for appropriation for the 2006 and 2005 fiscal years.

During March 2006, the Board recommended, and the Supreme Court of Pennsylvania approved, \$9,900,000 in grants to Pennsylvania legal Services for the grant period July 1, 2006 through June 30, 2007.

**NOTE 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 \$66,204 and \$87,177 as a result of the appeal during the years ended June 30, 2006 and 2005. Grants to pro bono programs (included in amounts in Note 4) by the Board totaled \$58,608 and \$54,700 during the years ended June 30, 2006 and 2005.

During March 2006, the Board recommended and the Supreme Court of Pennsylvania approved \$104,800 in Pro Bono grants for the grant period July 1, 2006 through June 30, 2007.

**NOTE 7 LEASES**

The Board leases office space in Harrisburg under a three-year operating lease. Lease expense for the years ended June 30, 2006 and 2005 amounted to \$21,820 and \$21,400, respectively. Minimum amount payable under the lease of \$17,770 is due for the year ending June 30, 2007.

**PENNSYLVANIA INTEREST ON LAWYERS TRUST ACCOUNT BOARD**

Notes to Financial Statements

For the Years Ended June 30, 2006 and 2005

**NOTE 8            RETIREMENT PLAN**

The Board sponsors a 403(b) retirement plan for employees. There were employer contributions of \$37,554 and \$31,266 to the plan for the years ended June 30, 2006 and 2005, respectively.

**NOTE 9            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 equal to the fair market value of the assets in the Rabbi Trust as of that date. The Board accrued \$18,578 for the agreement as of June 30, 2006.