LEGAL SERVICES CORPORATION

ACCOUNTING GUIDE
FOR
LSC RECIPIENTS

AUGUST 1997

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CHAPTER 1 - INTRODUCTION

1-1 Definitions

The following terms are used throughout this Guide and are defined as follows:

Accounting Guide	This Accounting Guide (Guide) for Recipients, which is issued by LSC.
Act	Public Law 93-355/Public Law 95-22 ("The Legal Services Corporation Act, as Amended") enacted by Congress July 25, 1974, amended December 28, 1977. [42 U.S.C. Section 2996 et seq.]
American Institute of Certified Public Accountants (AICPA)	The professional organization of CPA's. It promulgates auditing standards and, prior to 1973, accounting standards in Accounting Research Bulletins and Opinions, which have the same level of authority as Financial Accounting Standard Board Statements. Currently, through its senior technical body, the Accounting Standards Executive Committee (AcSEC) monitors the financial reporting standard-setting process and the activities of the AICPA accounting standards technical committees. The AICPA issues accounting standards and guidance in Statements of Positions, Audit and Accounting Guides, Practice Bulletins, and Issue Papers.
Annual Financial Statements	Include a Statement of Financial Position (or Balance Sheet), Statement of Activities, Statement of Revenue, Expenses and Changes in fund balances for state and local governments, Statement of Cash Flows, and notes to the financial statements.
Audit Guide	The current edition of the Legal Services Corporation Office of Inspector General (OIG) Audit Guide for Recipients and Auditors.
External Reporting	Financial Statement Reporting to outsiders, which must conform with GAAP.

Financial Accounting Standards Board (FASB)

A body appointed by the Financial Accounting Foundation and recognized under Rule 203 of the AICPA Code of Professional Standards to establish and improve financial accounting and reporting standards through the issuance of: Statements of Financial Accounting Standards, Interpretations, Technical Bulletins and Statements of Financial Accounting Concepts. In 1984, the FASB established the Emerging Issues Task Force (EITF) to provide guidance on new and emerging issues affecting financial reporting. The EITF issues Abstracts that report the accounting issues discussed, the results of the discussion, and the consensus reached.

Generally Accepted Accounting Principles (GAAP)

Accounting principles, practices or methods accepted as satisfactory by a significant number of recognized accountants organizations necessary at a particular time that represent accepted accounting principles and practices. Accounting principles encompass unwritten and written principles. The written principles are commonly referred to as promulgated GAAP. The current authoritative sources of GAAP are the FASB, EITF, Governmental Accounting Standards Board and AICPA.

Government Accounting Standards Board (GASB)

A body formed in 1984, GASB issues Statements, Interpretations, Technical Bulletins, and Concepts Statements which have the same level of authority for governmental entities as FASB pronouncements have for private sector entities and not-for-profit organizations.

Internal Control

A process effected by an entity's management and other personnel, designed to provide reasonable assurances regarding the achievement of objectives in the following categories: (1) Effectiveness and efficiency of operations; (2) Reliability of financial reporting; and (3) Compliance with applicable laws and regulations.

Internal Reporting

Internal recordkeeping and reporting for management and the governing body.

Office of Management and Budget Circulars

Directives issued by the Executive Office of the President to exercise managerial and policy direction and guidance over federal agencies. They provide policy guidance or processes over a broad range of subjects from instructions on financial management and control systems to auditing of and cost principles for state and local governments and not-for-profit organizations receiving federal awards.

Recipient	Any entity as defined in Section 1002(6) of the Act and any grantee or contractor receiving funds from the Corporation under Section 1006 (a)(1) or (a)(3) of the Act.
Subrecipient	Any entity that accepts Corporation funds from a recipient under a grant, contract or agreement to conduct certain activities specified by or supported by the recipient related to the recipient's programmatic activities. (See 45 CFR Section 1627.2(b)(1)).

1-2 Background

In 1974, the United States Congress established the Legal Services Corporation ("LSC" or "Corporation") to provide legal assistance to eligible persons in civil proceedings. Legal Services Corporation Act, PL. 93-355, 42 U.S.C. Section 2996 et seq. ("LSC Act"). The Corporation is a non-profit corporation located in the District of Columbia. Congress appropriates federal funds to LSC on an annual basis. LSC, in turn, makes grants, or enters into contracts, with private attorneys, qualified nonprofit organizations, state or local governments or substate regional planning or coordination agencies to provide legal assistance to eligible individuals.

Recipients are required to serve effectively and economically their clients in compliance with the LSC Act, annual LSC appropriations, other federal statutes, and LSC regulations, rules, guidelines, and policies. As with many other federally supported programs, LSC is required to evaluate recipients of its funds to ensure compliance with applicable laws.

1-3 Purpose

This guide is designed for use by recipients of LSC funds. The Guide sets forth financial accounting and reporting standards for recipients of LSC funds, and describes the accounting policies, records, and internal control procedures to be maintained by recipients to ensure the integrity of accounting, reporting and financial systems. In addition, the Guide includes illustrative appendices which describe accounting practices and procedures, such as the illustrative financial statements and chart of accounts, acceptable to LSC. These illustrations are not mandatory and do not preclude the exercise of the recipient's professional judgment in developing additional or alternative accounting and reporting procedures that meet LSC requirements.

This Guide is to be used in conjunction with, and is consistent with, the LSC Audit Guide.

In accepting LSC funds, recipients agree to administer these funds in accordance with the LSC Act, as amended, applicable appropriation riders, regulations, guidelines, policies, terms and conditions in effect at the time of the award.

1-4 **Authority**

LSC has prepared this Accounting Guide under the authority provided by the following sections of the LSC Act:

Records and Reports - LSC Act Section 1008:

“(a) The Corporation is authorized to require such reports as it deems necessary from any recipient, contractor or person or entity receiving financial assistance under this title regarding activities carried out pursuant to this title.”

“(b) The Corporation is authorized to prescribe the keeping of records with respect to funds provided by grant or contract and shall have access to such records at all reasonable times for the purpose of insuring compliance with the grant or contract or terms and conditions upon which financial assistance was provided.”

Audit - LSC Act Section 1009(c)(1):

> “The Corporation shall conduct or require each recipient, contractor, person or entity receiving financial assistance under this title to provide for an annual financial audit.”

Recipient's Non-LSC Funds - LSC Act Section 1010(c):

> “Non-Federal funds received by the Corporation, and funds received by any recipient from a source other than the Corporation, shall be accounted for and reported as receipts and disbursements separate and distinct from Federal funds...”

1-5 **Responsibilities of Recipients and the Submission of the Annual Financial Statement Audit**

Recipients are required to establish and maintain adequate accounting records and control procedures. Recipients are also required to provide for an annual financial statement audit pursuant to Section 1009(c)(1) of the LSC Act and in accordance with the Audit Guide.

1-6 **Responsibilities of the Auditor**

The responsibilities of a recipient's auditor are described in the LSC's Audit Guide.

1-7 **Responsibilities of the Financial Oversight Committee**

Each recipient's governing body must establish a financial oversight committee. The duties and responsibilities of the committee should be defined in the recipient's bylaws or a governing body resolution or operating policies and procedures. The committee should, at a minimum:

(a) Provide assistance to the board in fulfilling its fiduciary responsibilities relating to accounting and reporting practices;

(b) Maintain communication between the board and the auditor;

(c) Institute any changes necessary to ensure proper oversight and control of funds;

(d) Guide the process of selecting the recipient's auditor, including recommending to the governing body the appointment of a particular auditor;

(e) Meet with the auditor to discuss, inquire about and review audit reports and financial statements, and the effectiveness of the recipient's management of financial and accounting functions;

(f) Review and recommend the approval of the recipient's annual budget; and

(g) Review the recipient's periodic management reports.

1-8 **Relationship of the Accounting Guide to LSC Regulations**

LSC promulgates regulations that govern recipients' use of Corporation funds. These regulations appear in 45 CFR Part 1600 et seq. As a condition on their grants, recipients are required to adopt accounting policies and procedures that meet the requirements of these regulations, and to modify those policies and procedures as necessary when any of the regulations are amended or new regulations are issued. In this Guide, a number of these regulations are referred to because they establish accounting policies for the Corporation, but the content of these regulations is not repeated in the Guide. Instead, these regulations are included in Appendix VIII. Whenever such a regulation is referred to in the Guide, recipients should read the appendix for the full text of the specific regulation. Recipients should also update this appendix as and when these regulations are revised.

1-9 **Effective Date**

The effective date of this Guide is August 14, 1997. It supersedes all previous editions of Accounting Guidance.

1-10 **Revisions to the Guide**

LSC may periodically make revisions to this Guide. The recipient and its auditor should keep their copies of the Guide current, incorporating all revisions into the Guide upon receipt. It is the responsibility of the recipient to furnish copies of the current Guide, and revisions thereto, to its auditors.

1-11 **Cumulative Status of Revisions**

Effective Date	Description
August 1976	Original Edition of Audit and Accounting Guide for Recipients and Auditors issued.
June 1977	Revised Original Edition of Audit and Accounting Guide issued.
September 1979	Revision to Pages 4-1 and 6-6.
September 1981	Revision to Pages ii, 4-1, 6-6, VII-3, and addition of Page 4-2.
January 1, 1986	Revised Edition of Audit and Accounting Guide Issued.
May 1986	LSC permits recipients to use either Original or 1986 version of Audit and Accounting Guide.
August 13, 1986	Regulation 1630 Replaces Chapter 4 of both the Original and 1986 Edition of the Audit and Accounting Guide.
December 31, 1995	Chapter 6 of both Original and 1986 Audit and Accounting Guide replaced by November 1995 Audit Guide.
December 31, 1996	November 1995 Audit Guide replaced by November 1996 Audit Guide.
August 14, 1997	1997 Accounting Guide replaces all accounting portions of both Original and 1986 Audit and Accounting Guide.

CHAPTER 2 - ACCOUNTING, FINANCIAL MANAGEMENT AND REPORTING GUIDELINES

2-1 ACCOUNTING PRINCIPLES

2-1.1 OVERVIEW

This chapter discusses LSC's accounting, financial management and reporting guidelines. In general, LSC requires recipients and subrecipients (hereinafter recipients) of its funding to: (1) manage LSC and non-LSC funds in a stewardship manner and pursuant to the cost standards and procedures of 45 CFR Part 1630; and (2) record transactions in accounting records and prepare annual financial statements in accordance with GAAP.[1]

LSC recognizes that the applicability of these guidelines will vary among recipients; however, the guidelines contained in this Accounting Guide reflect GAAP methods that will result in the most meaningful financial information for LSC, and for most readers of an LSC recipient's financial statements. LSC prefers and recommends that its recipients report their LSC grant activity in a supplemental schedule to annual audited financial statements, if not separately reported in the basic financial statements.

2-1.2 PRINCIPLES

The purpose of the financial statements is to disclose the sources of the recipient's resources and how those resources were used, i.e., "Stewardship reporting." A recipient's accounting records should support the amounts disclosed in the financial statements.

Under GAAP, not-for-profit organizations and other entities that receive contributions are required to report in their financial statements contributions in various classes of net assets based upon the presence or kind of donor-imposed restrictions. In some instances, a recipient's total support will be provided by LSC; however, for most recipients there will be additional funding. There are two categories of support (i.e., grant revenue) that most recipients receive -- temporarily restricted and unrestricted.

> Temporarily Restricted Support are those resources which bear a legal restriction, imposed by the resource provider as to when and how they are used. Temporarily restricted support becomes unrestricted when it is expended in accordance with the restrictions or when the restrictions are removed by the resource provider. LSC grant revenue should be classified

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[1] For a listing of GAAP, see AICPA Statement of Auditing Standards No. 69, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles in the Independent Auditors Reports. Not-for-Profit organizations should also follow the AICPA Audit and Accounting Guide, Not-for-Profit Organizations. State and local governments should follow the AICPA Audit and Accounting Guide, Audits of State and Local governmental units.

in the financial statements as temporarily restricted revenue and as increases to temporarily restricted net assets until expended on LSC eligible activity, at which time they can be reclassified as unrestricted.

Unrestricted Support are those resources over which the recipient's governing body has discretionary control, within the limitations of its charter and bylaws, regarding when and how to use the resources in carrying on the recipient's operations. A recipient's funds from sources other than LSC, which would otherwise be categorized as unrestricted funds, are not rendered temporarily restricted by the fact that they many not be used for certain purposes pursuant to the terms of an LSC grant (see 45 CFR Part 1610).

In addition, some recipients receive and maintain permanently restricted funds in the form of endowments, with the principal of the gift or bequest remaining intact. Only the income from investing the principal may be used by the entity. Depending upon the terms of the endowment, income may either be spent at the discretion of the governing body or it may be restricted to a particular use. The provisions of the gift would determine the accounting treatment for the income and principal.

Each recipient should establish and maintain an accounting system to record separately grants, contracts and contributions. From its accounting records, a recipient should be able to prepare its financial statements in accordance with GAAP, including the requirement of separate records for net assets (fund balances), revenues, support, expenses, gains, losses and contributions based on the existence or absence of donor-imposed restrictions on funds.

Each recipient should evaluate the reporting requirements stipulated by each funding source to ensure that proper accounting and external reporting are followed in the financial statements and accounting records. GAAP requires that the financial statements:

(a) provide basic information that focuses on the organization as a whole and meets the common need of the external users (LSC and others) of the statements;

(b) provide a statement of financial position (balance sheet), a statement of activities (statement of revenue, support, expenses and changes in net assets), a statement of revenue, expenses and changes in fund balances for state and local governments (when applicable), a statement of cash flows, and notes to the financial statements; and

(c) report and classify net assets, revenues, expenses, and gains and losses based on the existence or absence of donor-imposed restrictions.

Net assets (i.e., grant revenues and contributions) not expended during an accounting period or designated for future periods are to be classified as either permanently restricted, temporarily restricted, or unrestricted net assets. At the end of the grantee's fiscal year, unexpired LSC grant contributions should be reported as temporarily restricted net assets.

The balance in each class of net assets is to be displayed in the statement of financial position, and the amount of change in each of those classes is to be displayed in the statement of activities. (See section on Financial Reporting for further discussion of recipient's financial statements.)

Because LSC requires separate disclosure as part of the financial statements (either within the overall statement of activities or as a separate schedule), LSC recipients should maintain a fund-based accounting system at least for LSC funds. Other grantors may impose similar requirements. In addition, within this system, recipients of LSC funds must maintain:

(a) a client trust fund and accounting system to account for funds held on the client's behalf; and

(b) a property fund to: (1) accumulate the cost (or fair value if donated) of building, furniture, fixture, equipment, leasehold improvements, and law library; (2) reflect depreciation and amortization thereon; (3) record gains or losses from the disposition of such assets; and (4) record any other transactions specifically relating to fixed assets.

2-2 FINANCIAL MANAGEMENT: ASSETS, SUPPORT AND FUND BALANCES

2-2.1 RECOGNITION OF LSC GRANT AND CONTRACT SUPPORT

LSC recipients should follow FASB Statement No. 116 -- Accounting for Contributions Received and Contributions Made. Specifically, LSC grant and contract support should be recognized and reported as a contribution with donor-imposed restrictions. LSC grant and contract funds along with derivative income should be recognized, classified and reported in the recipient's financial statements as temporarily restricted revenue and increases in temporarily restricted net assets. Temporarily restricted LSC net assets can be reclassified as unrestricted only when eligible expenses are incurred.

Also, LSC grant and contract revenue may be recognized as unrestricted revenue if the grant is fully expended during the grant period, i.e., the recipient's reporting period, and there are no carryover funds, i.e., net assets. If a recipient follows this treatment, this policy must be disclosed in the notes to the financial statements and consistently applied.

The accounting policies associated with grants and contracts must be disclosed in the notes to the financial statements. The details of the components of LSC support and net assets balances (unexpended current year funds or funds designated for future periods) must also be disclosed in the notes and/or schedule of awards.

For purposes of accounting and financial statement reporting, awards from LSC can generally be categorized into two distinct types:

> **Annualized Single or Multi-Year Grants/Contracts**: An annualized grant/contract is awarded to support a certain level of legal services activities over a specified period - most commonly the same one year period covered by a current federal appropriation. Annualized multi-year LSC grants provide assurance of a grant for one or more service areas for each year of the grant award. The amount is determined each year based on congressional appropriation and LSC funding policy.
>
> **One-time Grants/Contracts:** A one-time grant/contract can be awarded to support a specific event, project, or one-time purchase or activity, or it can be awarded as a one-time infusion of resources to support the recipient's annualized activities. One-time grants that are essentially one-time infusions to the annualized grant/contract should be recorded as support as eligible costs are incurred during the period specified in the grant/contract -- consistent with the accounting for the annualized grant/contract. Until expenses are incurred for the restricted activity, one-time grants in this category should be included and recorded in the recipient's financial statements as a liability (e.g., Grants Payable) on the statement of financial position. Executed one-time grants must be reported separately in the financial statements in accordance with 45 CFR §1628.3(e). This may be done by providing a supplemental schedule of related revenue and expense or a separate column within the financial statement reporting on grant activities. When a one-time grant or contract expires or is terminated, the unexpended amount is to be returned to LSC.

2-2.2 CASH AND INVESTMENTS

LSC funds held for immediate operating expenses must be maintained in federally-insured bank accounts. LSC funds in excess of the Federal Deposit Insurance Company limits and not needed for immediate operating expenses should be invested with another financial institution in federally-insured accounts or certificates, or invested in U.S. Treasury notes or bills or investment instruments, for example, money market accounts and repurchase agreements that invest in U.S. government securities.

If, after considering LSC's investment guidelines, a recipient adopts policies outside these guidelines, LSC will not override the judgment of the recipient's governing body. In such cases, the governing body must acknowledge, by resolution, the divergence from LSC's authorized policy and the acceptance of full responsibility for the security of any investments made outside of LSC's guidelines. In cases of losses of LSC funds related to investment decisions made outside of LSC guidelines, for purposes of personal liability, the governing body will be held to the standard of care imposed by applicable state or federal law.

GAAP requires that dividends, interest and other investment income be reported in the period earned as increases in unrestricted net assets unless the use of the assets (cash) received is limited by donor-imposed restrictions. LSC imposes such a restriction. LSC requires that any income such as interest and other investment income earned on its funds must be recorded and presented with LSC funds in the financial statements. Recipients may use such income for activities allowable with their current LSC grant.

LSC recipients are required to follow GAAP (See FASB Statement No. 124 -- Accounting for Certain Investments Held by Not-for-Profit Organizations) in the measurement of its investments. Information regarding the nature of and carrying amounts for each individual investment or group of investments must be disclosed in the notes to the financial statements.

2-2.3 CLIENT TRUST FUNDS

Client trust funds are funds received from or on behalf of a client. A separate escrow bank account must be opened and designated solely for client trust funds. A separate client trust record must be maintained for each client to document the receipt and disbursement of client funds. The total of the individual client trust records must equal the cash in the escrow bank account's corresponding liability accounts.

Client trust funds are not the property of the recipient and should not be reflected in the statement of activity. However, the cash in the escrow bank account, and an offsetting liability balance, are reported on the statement of financial position, and changes in the amount of client trust funds are reported in the statement of cash flows.

Recipients should consult with their bar associations for the proper handling of client trust funds. State escheat laws govern the disposition of unclaimed client trust funds. See Appendix V -- Accounting for Client Trust Funds.

2-2.4 PROPERTY

Recipients, for financial statement purposes, must capitalize and depreciate all nonexpendable items with a cost in excess of $1,000 and a useful life of more than one year. Recipients have the discretion to capitalize items with a lower value. Property should be presented in the financial statements in the class of net assets that were used to purchased the property. LSC recommends consultation with the recipient's auditor with respect to the proper reporting of property under GAAP.

LSC maintains a reversionary interest in all nonexpendable property (including real property) purchased in whole or in part with LSC funds by a recipient. For real property, specific terms for disposition will be determined between LSC and the recipient when approval is given for the purchase with LSC funds. For nonexpendable personal property, LSC's reversionary interest requires that property purchased with LSC funds must be disposed of in accordance with LSC's Property Management Manual or its duly adopted successor.

In view of the reversionary interest, asset accountability is critical. Capitalization of property is an integral part of discharging an LSC recipient's stewardship responsibilities over these assets. In addition to allowing the fair presentation of investments in property on the statement of financial position, capitalization helps ensure more effective controls over property and also subjects this account to auditing procedures. Accordingly, LSC requires capitalization of the cost of property (or fair value at the time donated). For similar reasons, LSC requires the recording of depreciation over an asset's useful life as an expense of rendering current services.

Although nonexpendable and real property purchased during a year will not be recognized as an expense for that year, the funds used for the purchase of that property are considered a current-year grant or contract charge.

The accounting policies for property should also be followed for a recipient’s law library. The costs of maintaining a law library should be expended currently. Judgments as to what constitutes a maintenance item and what constitutes a capital addition must be made after evaluating the nature and significance of the items in question. The law library may be depreciated over the useful life of the library for the difference between the original cost and the salvage value; if the salvage value approximates original cost, depreciation would be immaterial and therefore would not be necessary. LSC recommends consultation with the recipient's auditor with respect to the policies to be adopted.

Under GAAP, depreciation expenses should be reported in the statement of activities as a decrease in unrestricted net assets. If the property and equipment being depreciated have been contributed to the organization with donor-imposed restrictions on the item’s use, (e.g., property purchased with LSC funds) temporarily restricted net assets should, over time, be reclassified as unrestricted net assets in a statement of activities as those restrictions expire. The amount to be reclassified may or may not be equal to the amount of the related depreciation. The amount to be reclassified should be based on the length of time indicated by the donor-imposed restrictions while the amount of depreciation should be based on the useful economic life of the asset.

Reclassifications are also necessary if the entity has adopted an accounting policy that implies a time restriction on contributions of property and equipment that expires over the useful life of the contributed assets. Reclassifications should be included as “Net Assets Released from Restrictions” in a statement of activities.

LSC requires its recipients to depreciate property purchased with its funds based on the useful life of the asset. LSC property should be classified and reported in the financial statements as temporarily restricted net assets and reclassified as unrestricted in amounts equal to related depreciation. See Appendix I -- Illustrative financial statements -- Supplemental schedule for LSC grants.

For property control purposes, a physical inventory should be taken and the results reconciled with the property records at least once every two (2) years. Any differences between quantities determined by the physical inspection and those shown in the accounting records shall be investigated to determine the causes of the difference, and the accounting records should be reconciled to the results of the physical inventory with an appropriate note included in the financial statements, if determined to be material by the recipient's auditor.

Property and depreciation accounting practices are discussed and illustrated in detail in Appendix IV -- Accounting for Property.

2-2.5 DONATIONS

Donated items may include cash or cash equivalents, material, space, property and services contributed to recipients by individuals or organizations. In order to ascertain the total cost of providing legal assistance, such non-cash items, if their value can be clearly ascertained, should be recognized, recorded, and reported as "gifts-in-kind, contributions or donations" in the recipient's financial statements as both support and offsetting expenses.

Donated materials and property should be recorded at their fair value at the time donated and, in the case of nonexpendable assets, depreciated over their useful life. Fair value must be determined using the most objective and clearly measurable basis available. If the value assigned to donated items is material, the donation and valuation should also be approved by the recipient's governing body. Similarly, the free use of space and other assets should be recorded as a donation and recorded at the fair value of the use, with an offsetting charge to the applicable expense.

Donated items should be reported in the financial statements as revenue in the class of net assets appropriate to any donor-imposed restrictions on the contribution. If there are no restrictions, the revenue from the contribution is recorded as unrestricted. If the donation is initially reported as temporarily restricted, the restriction is deemed to expire ratably over the useful life of the asset, i.e., in proportion to depreciation for a comparable depreciable asset. The expiration is reported as a reclassification from the temporarily restricted to the unrestricted class of net assets.

Donated services recognition in the financial statements is critical to a reasonable evaluation of the total cost and scope of legal assistance provided by recipients. GAAP set forth fairly specific criteria which, if met, require the recording or, if not met, preclude the recording of donated services. (See FASB Statement No. 116. ¶ 9 -- Contributed Services) LSC recommends consultation with the recipient's auditor with respect to the proper reporting of donations under GAAP.

Under GAAP, contributed (donated) services should be reported as contribution revenue and as assets or expenses only if the services create or enhance a nonfinancial (i.e., nonmonetary) asset (e.g. property and equipment) or require specialized skills that are provided by individuals possessing those skills (such as accounting, financial, construction, educational, electrical, legal, medical, and other services provided by accountants, investment advisers, contractors, teachers, electricians, lawyers, doctors, and other professionals and craftspeople), and would typically need to be purchased by the organization if not provided by donations.

If contributions are reported, they should be measured at fair value. The dollar value assigned to donated services should be reflected as unrestricted revenue in the financial statements. On the expense side, the value of such services should be allocated to program and supporting services categories based on the nature of the work performed. The recording of donated services will not affect net assets, since the income and expenses offset each other. The notes to the financial statements should disclose the nature of donated services and the valuation techniques followed.

LSC recommends that each recipient establish a method to value and record donated services. Normally, the valuation should be at what the cost to the recipient would have been if the services had been purchased by the recipient. Adequate records must be maintained during the year to support the value of donated services recorded, but the actual recording of the services could be done quarterly or at year-end.

For professional legal services, two methods are suggested as providing sufficient documentary support -- a predetermined fee schedule or an hourly rate. A major advantage of the fee schedule is that it can be used without having to impose timekeeping requirements on those professionals donating their time to the program. The subject of the adequacy of support for donated services should be discussed with the recipient's auditors. It is usually not necessary to impose detailed record keeping requirements upon donors as long as internal records are adequate and provide an audit trail. Also, see 45 CFR Part 1635 for LSC Timekeeping Requirements - Appendix VIII -- Corporation regulations setting accounting policies.

Whether or not professional legal services rendered to clients as part of a recipient's private attorney involvement effort (See 45 CFR Part 1614) should be reported as donated services depend on whether GAAP requirements are satisfied. LSC recipients should also give close attention to the following example from FASB Statement No. 116, ¶180:

> *Organization E develops and maintains a list of lawyers and law firms that are interested in providing services without charge to charitable organizations and certain individuals. Organization E encourages individuals in need of free legal services to contact Organization E for referral to lawyers in the individual's community that may be willing to serve them. The decision about whether and how to serve a specific individual rests with the lawyer. Under those circumstances, Organization E merely acts as an intermediary in bringing together a willing donor and donee. The free legal services are not a contribution received by Organization E.*

2-2.6 COURT-AWARDED ATTORNEY FEES

Pursuant to 45 CFR Part 1642, no recipient may claim or collect and retain attorneys' fees for any case filed after April 25, 1996. An attorney's fee is defined in this part as "an award to compensate an attorney of the prevailing party made pursuant to common law or Federal or State law permitting or requiring the awarding of such fees or a payment to an attorney from a client's retroactive statutory benefits." To claim attorneys' fees means to include a request for attorneys' fees in any pleading.

Attorneys' fees may be claimed and collected in a case filed prior to April 26, 1996, except that fees may not be claimed and collected for any additional, related claim arising after April 25, 1996, in such a case. Recipients shall account for awards of attorneys' fees from cases filed prior to April 26, 1996 in accordance with 45 CFR §1642.5. See Appendix VIII.

2-2.7 DERIVATIVE INCOME

LSC considers derivative income as any additional income derived from an LSC grant, such as interest income, rent or the like, or that portion of any reimbursement or recovery of direct payments to attorneys, proceeds from the sale of assets, or other compensation or income attributable to any Corporation grant. LSC derivative income must be reported in the same class of net assets that includes the LSC grant.

2-2.8 NET ASSETS

LSC policy regarding the use of temporarily restricted net LSC assets (fund balances) carried over from one grant year to the next are governed by 45 CFR Part 1628. Carryover LSC funds are required to be expended prior to the expenditure of current grant funds awarded for the same purposes on a first in, first out basis.

Should expenses during a period exceed support, LSC is not obligated to fund the deficit. The deficit should be charged to other funds that are available to the program. However, LSC retains the discretion to allow deficits to be carried over in a statement of net LSC assets and be absorbed during future periods. See 45 CFR §1628.5. See Appendix VIII.

2-2.9 SUBGRANTS

Recipients may, with LSC prior approval, delegate LSC funds by grant or contract to a subrecipient such as a bar association or another legal services program to carry out specified program activities. The subgranting of LSC funds, the recipient's responsibility for subgranted LSC funds and the proper financial statement reporting of a subgrant are governed by 45 CFR Part 1627. The subgrant or contract with the subrecipient should specify financial reporting responsibility. Where a relationship with a subrecipient exists, the notes to the financial statements of the recipient and subrecipient should fully disclose the nature of that relationship.

2-3 FINANCIAL MANAGEMENT: EXPENDITURES AND LIABILITIES

2-3.1 GRANT AND CONTRACT COSTS

LSC regulation 45 CFR Part 1630 provides uniform standards governing the allowability and allocability of costs charged to LSC grants and contracts, and also provides a comprehensive, fair, timely, and flexible process for the resolution of questioned costs incurred by LSC recipients. Recipients should review this regulation when considering whether a cost can be charged to an LSC grant or contract.

In general, many sections of Part 1630, and many of its terms, are patterned after the provisions of OMB circulars. However, LSC's statutory provisions, rules, regulations, guidelines and instructions, including this Accounting Guide, are the primary sources of LSC cost principles, and OMB circulars provide guidance as to LSC's cost principles only to the degree that they are not inconsistent with relevant LSC policies or criteria. See 45 CFR § 1630.4(g).

2-3.2 COST ALLOCATION

LSC anticipates that recipients receiving funds from multiple sources will incur expenses (e.g., salaries, space, travel) which support work performed under more than one grant, contract, or other funding agreement. Such common costs should be allocated among the funds on the basis agreed to by the applicable organization. LSC's rules regarding allocations among funds are set forth in 45 CFR Part 1630.

2-3.3 EMPLOYEE BENEFITS

The accounting for employee benefits should follow the accrual method of accounting, which requires that the expense and liability associated with the benefits that have vested with the employee be recorded currently. This procedure is required for financial statements prepared in accordance with GAAP. An example of a benefit with year-end accrual would be vacation leave earned by employees and vested, but not taken (FASB Statement No. 43 -- Compensated Absences). In addition, there should be a note to the financial statements that discloses the amount of the liability for vested employee benefits at the financial statement date. LSC also recommends consultation with the recipient’s auditor in this area.

2-3.4 PRIVATE ATTORNEY EXPENDITURES

LSC policy regarding expenditures for private attorney involvement (PAI) is set forth in 45 CFR Part 1614. See Appendix VIII.

For financial reporting of PAI activity, support and expenses related to the effort must be reported separately in the recipient’s annual financial statements. This may be done by providing a separate schedule or column in the financial statement reporting on grant activity or a note to the financial statements that accounts for the entire PAI allocation.

Accounting for judicare payments should follow the accrual method of accounting, which requires that the expenses and liabilities associated with judicare cases be recognized during the period in which the services are rendered by the participating attorney, rather than when the case is assigned to the attorney. Although programs are encouraged to develop encumbrance systems to control and account for adequately judicare cases, the actual expense for judicare payments must be determined under the accrual method.

Encumbrances or reserves should be disclosed in the notes to the financial statements as commitments of the program. LSC recommends consultation with recipient's auditor for the proper reporting of contingencies under GAAP.

2-3.5 RESTRICTIONS ON EXPENDITURES OF PUBLIC, PRIVATE AND TRIBAL FUNDS

The applicability of restrictions on the use of LSC funds to a recipient's use of funds from public, private and tribal sources is set forth in 45 CFR Part 1610. See Appendix VIII.

2-4 FINANCIAL REPORTING

2-4.1 OVERVIEW

This section discusses the recipient's external financial reporting requirements in accordance with GAAP, specifically, the FASB Statement No. 117 -- Financial Statements for Not-for-Profit Organizations.

Most LSC recipients are funded by a variety of funding sources, some of which require a separate reporting of how their funds were utilized in the recipient' s operations. LSC requires separate reporting of its grants or contracts in a recipient's financial statements. LSC prefers and recommends that a supplemental schedule of LSC grant activity be provided, which reports grant activity by expense category, net asset balance(s) and is reconcilable to grant award information disclosed in the financial statements and LSC records.

Most federally-funded grants or contracts and some privately funded awards include this requirement. If unclear, the recipient should resolve this issue with the appropriate officials from the funding sources. The recipient should attempt to include all funds from funding sources that do not have a separate reporting in a single temporarily restricted class of net assets or unrestricted class of net assets depending on the circumstances.

LSC requires that recipient’s financial statements be prepared in accordance with this Accounting Guide and GAAP and include the entire financial resources of the recipient, including all non-LSC funds. This provision is consistent with the Federal Government's emphasis on conducting organization-wide audits. The provision for full disclosure allows LSC and others to assess and evaluate the total legal assistance effort being provided by recipients.

This requirement means that the recipient's accounting records must accommodate the accumulating and supporting of costs by grant and contract. An LSC recipient's accounting records maintained on a fund accounting basis should provide an adequate basis upon which to prepare its annual financial statements.

2-4.2 ANNUAL FINANCIAL STATEMENTS

GAAP, in FASB Statement No. 117, requires not-for-profit organizations to present, at a minimum, aggregated financial data for total assets, total liabilities, total net assets (excess of assets over liabilities - similar to fund balances), and total change in net assets. Within the classes of net assets, only donor-restricted revenue, net assets by class, and change in net assets by class must be shown, but recipients are free to present additional disaggregated data.

Financial statements submitted to LSC must comply with GAAP. LSC prefers and recommends that its recipients report their LSC grant activity in a supplemental schedule to annual audited financial statements, if not separately reported in the basic financial statements.

Functional expense reporting: FASB Statement No. 117 requires the Statement of Activity for all not-for-profit organizations to report expenses by functional classification, such as program services and supporting activities, or by natural classification provided that functional classification of expenses is provided in a separate schedule or note to the financial statements.

Supporting activities include both management and general, and fundraising expenses. For LSC recipients, "program services" are activities that result in delivering legal assistance to eligible clients which is the purpose(s) or mission for which the program exists, and include both cases and matters. These terms are defined in 45 CFR Part 1635 -- Timekeeping Requirements.

LSC prefers and recommends that its recipients report expenses of LSC funds in natural categories of expense in a supplemental schedule to the financial statements, if not separately reported on the statement of activities.

Recipients may exercise their judgment in determining whether all program services should be reported together or whether their activities can better be presented, pursuant to FASB Statement No. 117, through reports of two or more types of program services. "Supporting activities" are all activities of a not-for-profit organization other than program services. See 45 CFR Part 1635. See Appendix VIII.

<u>Classes of Net Assets Subdivided:</u> The requirement to disclose the aggregate of the net assets of each of the three classes does not preclude subdividing any or all of the net assets amounts into two or more subcategories. However, where this is done, these subcategories must be aggregated to show the total net assets of that class. LSC's net asset balance may be disclosed separately on the Statement of Financial Position and in agreement with the amount(s) shown on the Statement of Activity or in a supplemental schedule which shows LSC grant activity, i.e., grant support and revenue, expenses and the resulting net asset balance, if any.

Some not-for-profit organizations choose to segregate their fixed assets in a separate fixed asset category. The resources that are used to purchase such fixed assets can be both restricted and unrestricted. FASB Statement No. 117 does require that all net assets amounts be categorized into one of the three classes. LSC recommends consultation with the recipient's auditor with respect to the proper financial statement reporting of property under GAAP. The notes to the financial statements should disclose property purchased with LSC and non-LSC funds.

<u>Total of All Classes:</u> LSC requires recipients to display a "Total of all classes" column in the financial statements where a multi-column presentation is shown. Care must be taken to assure that all appropriate disclosures are made either in the net assets section or in the notes to the financial statements, to make certain the captions are not misleading.

Sample financial statements, illustrating formats that contain the disclosures required by FASB Statement No. 117, and in a supplemental schedule reporting LSC grant activity are shown in Appendix I.

2-4.3 FISCAL YEAR-END

LSC will normally fund each recipient on a calendar-year basis, but a recipient's fiscal year-end need not be the same as LSC's grant year. Changes in a recipient's fiscal year-end require prior written notification to both the LSC Office of Program Operations and the LSC Office of Inspector General.

2-5 <u>ACCOUNTING RECORDS</u>

This section describes the accounting records that shall be maintained by each recipient. In general, accounting records shall be maintained on a double-entry basis using fund accounting and must be adequate to enable a recipient to prepare its annual financial statements, internal reports, and other management reports.

A recipient's accounting records can be maintained by either a manual or an automated system. Each recipient should establish the system most appropriate to its needs and provide an adequate audit trail for all transactions.

At a minimum, a recipient's accounting records should consist of a General Ledger, Cash Receipts Journal, Cash Disbursements Journal, General Journal/Journal Voucher, Client Trust Records, Payroll Records, and Property Records. See Appendix II for the types and descriptions of accounting records a recipient should maintain and retention times for records of not-for-profit organizations.

CHAPTER 3 - INTERNAL CONTROL/FUNDAMENTAL CRITERIA OF AN ACCOUNTING AND FINANCIAL REPORTING SYSTEM

An LSC recipient, under the direction of its board of directors, is required to establish and maintain adequate accounting records and internal control procedures. Internal control is defined as the process put in place by the recipient's board of directors, management, and other personnel which is designed to provide reasonable assurance of achieving the following objectives:

1. safeguarding of assets against unauthorized use or disposition;

2. reliability of financial information and reporting; and

3. compliance with regulations and laws that have a direct and material effect on the program.

A financial statement audit will not prevent defalcations, nor will it provide for all the financial information needs of management. It is not intended for those specific purposes. Each program must rely instead upon its own system of internal accounting controls and procedures to address these concerns. This chapter discusses the Fundamental Criteria of an Accounting and Financial Reporting system with which recipients must comply to demonstrate effective discharge of stewardship responsibilities.

3-1 DEFINITION

The Fundamental Criteria encompass the coordinated methods and measures that should be adopted by recipients of any size to safeguard assets, check the accuracy and reliability of accounting data, promote operating efficiency, and encourage adherence to prescribed management policies. Variations from this model should only be made when justified by particular program characteristics. The Fundamental Criteria emphasize the results to be achieved. However, there can be substantial flexibility in the methods implemented to achieve the required results.

3-2 OBJECTIVES

1. The Fundamental Criteria are intended to provide criteria which allow a nonfinancial manager to assess whether the system for which he or she is responsible reduces inherent financial management risks sufficiently to demonstrate the proper discharge of his/her stewardship responsibilities.

2. In addition, the Fundamental Criteria are intended to provide standards which allow program personnel to evaluate performance in the financial area in accordance with consistent criteria, and to make improvements, as needed.

3-3 CHARACTERISTICS

In establishing an adequate system of internal control, certain basic concepts must be considered recognizing that each recipient is unique, and, therefore, any control procedures must likewise be unique and "custom made."

3-4 INTERNAL CONTROL STRUCTURE

In establishing an adequate internal control structure, the following items must be considered:

1. Competent Personnel: Each recipient must have adequately trained, competent accounting personnel to properly document, record, account for, and report financial transactions.

2. Definition of Duties and Responsibilities: The duties and responsibilities of all recipient personnel must be detailed in written job descriptions. Job descriptions for accounting personnel must specify, at a minimum, those individuals who, for example, approve invoices for payment, prepare grant and contract reports, maintain accounting records, prepare management reports.

3. Segregation of Duties: Accounting duties should be segregated to ensure that no individual simultaneously has both the physical control and the record keeping responsibility for any asset, including, but not limited to, cash, client deposits, supplies and property. Duties must be segregated so that no individual can initiate, execute, and record a transaction without a second independent individual being involved in the process.

4. Establishment of Independent Checks and Proofs: Recipients must establish independent checks and proofs consisting of regular internal verification of the recording of transactions and on the preparation of financial reports.

5. Establishment of an Accounting Manual: Each recipient must develop a written accounting manual that describes the specific procedures to be followed by the recipient in complying with the Fundamental Criteria.

LSC recommends consultation with recipient's auditor in determining and establishing appropriate levels of internal controls within the recipient's organizational size and structure.

3-5 FUNDAMENTAL CRITERIA

The Fundamental Criteria described in this section is a codification of the elements of an adequate accounting and financial reporting system. Compliance with the Fundamental Criteria set forth below reduces the possibility of a recipient experiencing serious financial difficulties. The "Risks" column illustrates some frequent difficulties which may result from a recipient having inadequate internal controls. At the same time, the Fundamental Criteria described are not intended to include all possible control methods, or to identify all potential risks resulting from internal control weaknesses. Appendix VII contains an accounting procedures and internal control checklist to be used as a guideline by recipient's management in developing or improving accounting systems and internal control procedures.

Key Elements	Criteria	Aids in Evaluating Criteria	Risks
3-5.1 <u>CONTROL, ROLES AND RESPONSIBILITIES</u>			
Financial Planning and Control	Each recipient must formally enunciate a financial philosophy in its accounting manual. This manual shall govern the overall financial planning and control function of management.		
Define and Communicate Roles and Responsibilities	The appropriate roles of the governing body and management must be defined in the accounting manual. The flow of authority and responsibility from the governing body to top management and to successively lower levels of management must be identified clearly and communicated to relevant personnel.	A recipient's governing body should use bylaws and resolutions to define and communicate its own authority and responsibility and what is delegated to top management. Similarly, top management should use organization charts, job descriptions, policy statements, and other techniques to define and communicate the authority and responsibilities of lower personnel. Plans (goals and priorities and budgets), should also be used to define and communicate the objectives of and limitations on individual activities. Merely defining authority and responsibility does not, in and of itself, discharge the responsibility of the financial planning and control function. In addition: -Job responsibilities must be communi- cated to personnel who need to know; and -Techniques must be devised to provide reasonable assurance that the criteria are observed in day-to-day operators.	Unless authority and responsibilities are clearly defined, an organization may be misdirected. A misdirected organization is unlikely to achieve success in controlling fiscal duties and responsibilities or achieving its objectives. A failure to identify proper roles and responsibilities will result in transactions, adjustments and journal entries that (1) are not in accordance with management criteria, (2) are not processed or are processed late, or (3) are processed in a careless manner.
Be Explicit	Communications of authority should be explicit and, to the extent possible, should be in writing.	Explicit communications of authority are most often found in bylaws, resolutions, policy and procedures statements.	Implicit, unwritten delegations of authority and "understood" criteria often lead to misunderstandings and less than efficient operations.

Key Elements	Criteria	Aids in Evaluating Criteria	Risks
Financial Controls	Financial controls shall be established to safeguard program resources.	The financial authority of supervisory personnel should be clearly defined and evidenced by: -Established policies for processing, recording and reporting financial transactions; -Documentation identifying the authority delegated to supervisory and other personnel to initiate and approve financial transactions; and -Criteria to be used when modifying or eliminating the above procedures.	Without adequate controls and definitions of responsibilities: - Projects or other transactions may be initiated that violate management intentions, or legal or grant restrictions; - Resources may be wasted on duplicative efforts or used for unauthorized purposes; and -A negative attitude toward internal accounting controls may develop within the recipient.
Translate Goals into Financial Terms	Goals and priorities translated into financial terms should be established.	At a minimum, the translation of goals and priorities into financial terms is represented by a budget. The annual budget of the program should be approved by the program's governing body or its finance/audit committee, reviewed in detail by the finance/audit committee of the governing body, and reviewed and approved by the governing body as a whole.	Without careful planning that relates goals and priorities to the financial resources available, the fiscal integrity of the recipient and essential program goals may be jeopardized.
Analyze effect of management decisions on fiscal operations.	Analyze and assess the financial effect of management decisions before and after implementation.	Timely and accurate financial management reporting is essential in analyzing management decisions such as hiring additional staff, opening or closing offices, expanding or retrenching service areas, etc.	Without adequate financial management reports, management may commit resources to activities or services which it cannot afford. The resulting deficit in operations could adversely effect the provision of services.
3-5.2 ANNUAL FINANCIAL STATEMENTS AND AUDIT REPORTS			

Key Elements	Criteria	Aids in Evaluating Criteria	Risks
(a) ANNUAL AUDIT: LSC's Audit Guide	The annual audit of the financial statements should be performed in accordance with LSC's Audit Guide for Recipients and Auditors.	Review the annual audit report and any audit related correspondence from LSC.	Without an annual audit in conformity with the LSC Audit Guide, significant audit problems may remain undisclosed and adversely effect proper discharge of the fiduciary responsibilities of the governing body.
Time of Reporting	The audit report should be submitted to LSC in accordance with the LSC Audit Guide. Under extraordinary circumstances, written extensions may be granted by LSC's OIG.	Review the recipient's history of timely submission of audit reports, and the reason(s) for any untimely submissions.	Consistently delinquent audit reports may indicate a serious problem with management effectiveness or accounting procedures.
Management Letter	The audit report should be accompanied by the auditor's management letter.	Review the management letter and the corrective action recommended.	While a recipient may receive a "clean opinion" from the auditor, there are often many areas in which the auditor can make suggestions for improved financial control. The management letter provides the forum for such comments. System deficiencies may not be materially significant now; but if not corrected could become significant in the future.
(b) GOVERNING BODY: Financial Oversight Committee	Each recipient's governing body shall appoint/elect a financial oversight committee and identify the duties of the committee in writing.	Insure that the duties of the audit committee are documented in writing. Insure that the financial oversight committee meets regularly.	The absence of a financial oversight committee deprives the governing body of the use of one of the most effective tools available to assist in the proper discharge of its fiduciary responsibilities.
Approval of Auditors	The governing body should approve the appointment of the auditors.	Review the manner in which an auditor is selected.	Auditors report to the individual or body that hires them. Management should not be the sole source in the control of reporting on the financial performance of its programs since LSC and interested third parties customarily rely on the auditors.

Key Elements	Criteria	Aids in Evaluating Criteria	Risks
Exit Conference	The governing body minutes should reflect that the annual audit report and auditor's management letter were discussed with governing body members, management and the auditors, and deficiencies, if any, were satisfactorily addressed.	A review of the documentation on the exit conference should include a discussion of significant weaknesses, if any, and corrective action prescribed by the governing body.	The failure to have an exit conference with management and the governing body or its audit committee deprives the auditor and program personnel of the opportunities to obtain additional information to improve operations.
Minutes	The governing body shall have policies defining appropriate parameters for fundamental financial decisions. All financial decisions within these parameters should be recorded in the minutes. Appropriate parameters should be sufficient to ensure that the financial operations are discharged adequately.	Minutes should record financial decisions made and/or approved by the governing body.	Lack of documentation in the minutes may result in inadequate communication to management. In addition, it will be difficult to later demonstrate that the governing body had adequately discharged its fiduciary responsibilities.
(c) AUTHORIZATION BY THE GOVERNING BODY: Bank Account(s)	Each bank account shall be authorized by the recipient's governing body. There should be sufficient justification for using more than one operating bank account. Any account not used should be closed promptly, and the bank should be notified in writing not to process any subsequent transactions. Any remaining blank checks for closed accounts should be destroyed promptly.	Governing body minutes should reflect governing body approval of new bank accounts, and ratification of bank accounts which have been closed. Relevant state escheat laws should be reviewed.	Dormant bank accounts provide greater opportunities for individuals to fraudulently disburse cash and cover the disbursements in the records.
Check Signing	All check signers should be designated by the governing body. Authorized check signers who are no longer with the program should have their authorization to sign checks canceled promptly on the bank(s) records.	Governing body minutes should reflect the designation of authorized check signers. A log should be kept of all persons authorized to sign checks. This should be updated as people are added or deleted and the date the bank was notified indicated beside the name.	Checks may be fraudulently issued with signatures that are no longer or never were authorized.

Key Elements	Criteria	Aids in Evaluating Criteria	Risks
(d) RECONCILIATIONS: Monthly	Bank statements shall be reconciled monthly to the general ledger by a person who has no access to cash, who is not a regular check signer, and has no cash bookkeeping duties.	Reconciliation procedures shall be documented to ensure timeliness and accuracy.	Proper reconciliation procedures will substantially increase the likelihood of irregular disbursements and recording errors being discovered on a timely basis. The reconciliation procedure is a fundamental control technique and failure to use it may be interpreted as negligence, especially in an environment where full segregation of duties is not practicable.
Documentation	The reconciliation shall be reviewed and approved by a responsible individual. Such review shall be appropriately documented by signature and date.	Review the monthly bank reconciliation(s) with regard to the following: -Has a reconciliation been prepared for each bank account? -Is the reconciliation assigned to someone with no bookkeeping duties? -Is the person reviewing and approving the reconciliation doing so effectively? -Is the review and approval documented on the reconciliation sheet? -Is the nature and amount of reconciled items clearly indicated on the reconciliation sheet?	
Adjustments	All required adjustments to the general ledger cash account identified through the reconciliation procedure should be recorded in the general journal and promptly posted to the general ledger.	Determine that adjustments to the cash account which have been identified on the reconciliations have been properly posted to the general journal and general ledger.	
3-5.3 CASH RECEIPTS			

Key Elements	Criteria	Aids in Evaluating Criteria	Risks
INITIAL CONTROL Accountability	Initial accountability for cash should be established as soon as a cash item is received. This responsibility should be assigned to a person with no other bookkeeping duties.	Non-accounting individuals should be assigned to receive and record cash receipts. This is the most fundamental safeguard in protecting against irregularities.	The major risk in this area occurs when an individual with record-keeping responsibilities is also responsible for establishing the initial accountability for cash. Such an individual could cash a check or money order and then adjust the records to cover irregularities.
Mail	Accountability should begin with the individual opening the mail.	The mail should be opened by a person with no other bookkeeping duties, when possible.	If cash is received at more than one location, risk is increased.
Endorsement	The checks should be restrictively endorsed by the individual opening the mail.	The endorsement should be stamped on the check.	Checks not endorsed or endorsed with no restriction can be cashed by unauthorized individuals.
Cash Receipts Log	Each receipt should be recorded in a log by the person opening the mail.	The cash receipts log should list the amount and payor for each check or other cash item received.	Absence of a listing precludes a double check that all cash receipts were recorded and deposited on a timely basis.
Deposit	All receipts should be deposited at least once a week (daily when possible).	Review deposit slips to monitor the frequency and timeliness of deposits.	Undeposited items risk being lost or misappropriated.
Accounting Record: Source and Purpose	The accounting records should adequately identify all cash receipts as to source and purpose.	Review the receipts journal to determine that both the source and purpose of cash receipts are clearly identified.	Lack of control over cash means it may go unrecorded and Undeposited.
Receipt to Deposit	Fiscal records should allow an individual to trace the receipt from initial listing to the deposit in the bank account to the general ledger posting.	Trace cash receipts from the initial listings through the cash receipts record to the general ledger. If a reviewer is unable to do this, the system is inadequate.	Inadequate recordkeeping may allow deposits to go unrecorded in the appropriate ledgers. This may result in inaccurate financial statements and management reports.
3-5.4 CASH DISBURSEMENTS			

Key Elements	Criteria	Aids in Evaluating Criteria	Risks
(a) MANAGING PURCHASES: Purchase Approvals	Approval should be required at an appropriate level of management before a commitment of resources is made.	Criteria for purchases should be documented along with appropriate procedures.	Failure to follow the purchase approval process may result in purchases made without the knowledge of appropriate management or at unacceptable prices or terms.
Invoice and Receipt Verification	The receipt of goods and the accuracy of invoices should be verified and documented.	Prenumbered and controlled receiving documents, a receiving log, or a receipt verification on the invoice should document that goods and services were actually received. Verification procedures to validate, among other things, vendor numbers, quantities, and amounts should be reviewed.	Without adequate internal verification, cash may be disbursed for goods and services not received, in advance of receipt, or in the wrong amount.
Control over Duplicate Payments	Documents should be marked paid or otherwise canceled to avoid duplicate payment. The check number and pay date should also be noted on the invoice or other supporting documentation.	Procedures for preparing, voiding, safeguarding, or otherwise canceling source documentation to prevent reuse (e.g., vouchers, invoices, and adjustment forms) should be established.	Inadequate document control may result in duplicate payments.
(b) CHECK PREPARATION: Prenumbered	All disbursements (other than petty cash) should be made by pre-numbered checks.	A review of the existence and consecutive use of pre-numbered checks should be conducted.	Without prenumbered checks, cash may be improperly disbursed or recorded.
Authorized Signature	All checks should be signed by an individual(s) authorized by the governing body.		Failure to adhere to the check signing authorizations may result in unauthorized disbursements.
Payees	No checks may be made payable to cash. Generally, checks should not be made payable to employees except expense reimbursements and payroll checks. There should be a written prohibition against signing blank checks.	Samples of actual canceled checks should be reviewed to determine that the payee has not been altered and that endorsements are consistent with the approved use.	Checks made payable to cash are not adequately identified with the person cashing the check. A check to "cash" is negotiable and therefore does not protect against the improper cashing of a lost or misplaced check.

Key Elements	Criteria	Aids in Evaluating Criteria	Risks
(c) RECORDKEEPING: Disbursements Journal/Voucher Register	An effective method shall be established to initially record and categorize disbursements and then summarize them for recording in the general ledger.	Review the cash disbursements journal or other methods used to initially record checks or purchases with regard to the following: -Are disbursements organized to allow for a summary expense category? -Are disbursements posted to the general ledger on a current basis, i.e., monthly? -Are all checks listed in numerical sequence including voided checks? -Do the subsidiary records agree with the posting to the general ledger?	An ineffective method for initially recording disbursements may adversely affect the ability to accurately report to management on actual expenses.
Disbursement Filing System	An organized method shall be established to accumulate and file all documents relating to a particular disbursement for future reference.	Select a sample of disbursement checks and trace them to their source documents. Are the supporting documents contained in the files?	Improper filing of source documents could result in unauthorized disbursements.

Key Elements	Criteria	Aids in Evaluating Criteria	Risks
Property Record	Property purchases should be recorded in a property subsidiary record. The property record should include: - description of the property - date acquired - check number - original cost - fair value (if donated) - method of valuation (if donated) - salvage value, if any - funding source - estimated life - depreciation method - identification number - location The property subsidiary record must agree with the general ledger property accounts.	Have the detailed property records been added and reconciled to the general ledger control accounts? Did the totals agree? Were any differences reconciled and adjusted?	Failure to maintain adequate property records may result in the inability to fully account for fixed asset purchases, and to support depreciation amounts and property asset balances.
Petty Cash	Petty cash funds should be maintained on an impress basis and recorded in the general ledger.	Review petty cash reimbursements periodically to ensure required procedures are being followed. Occasional surprise counts greatly reduce the opportunities for misuse of petty cash.	Without management review and control the petty cash account is readily subject to misuse.

Key Elements	Criteria	Aids in Evaluating Criteria	Risks
(d) REVIEW OF DISBURSEMENT PROCEDURES		Review a sample of cash disbursement checks, including, among others, those with large amounts, round dollar amounts, unfamiliar vendors, payments to employees, and board members. -Are the checks supported by adequate documentation? -Is there documentation on the invoice indicating that it was checked? -Was the item purchased in accordance with procedures? Namely, is there documentation of who initiated and who approved the purchase? -Was evidence of the receipt of goods or services noted? -Was the invoice canceled? -Was it posted to the appropriate general ledger account to which it was coded? -Was the supporting documentation contained in the files?	

Key Elements	Criteria	Aids in Evaluating Criteria	Risks
3.5.5 PAYROLL			
(a) RECORDS: Payroll Register	The payroll register should list all payments to employees by name, check number, gross pay, withholdings, and net pay.	Review the payroll register for content and accuracy. Also obtain the latest quarterly withholding reports from the federal and state authorities to determine that they were filed on time and that taxes were withheld properly.	The lack of an adequate payroll register may result in: -Unauthorized amounts withheld from employees; -Employees being paid unauthorized amounts; -Improper tax withholding; and -Employees being paid for days not worked.
Attendance Record or Time Record	An attendance record or time record shall be maintained for each employee and shall be approved by the employees supervisor.	Review time and attendance records to determine if they have been properly approved by supervisory personnel and that salary payments correspond to hours reported.	Employee may be paid for days or hours not worked.
Vacation and Sick Leave and Overtime/ Compensatory Time	A record of vacation and sick leave time and overtime/compensatory time shall be maintained for each employee. It should include the time accrued and taken and the available balance.	A review of several employees' personnel files will indicate the adequacy of records maintained.	Inadequate records may result in an employee receiving unauthorized leave and/or payments.
Individual Earnings	A record of cumulative individual earnings and withholding amounts shall be maintained for each person.		Recording every payroll transaction on an individual earnings record will assist in preventing duplicate payments.
Payroll Records	Each employee shall have a payroll/personnel file which includes, among other things, documentation concerning appointments, position reclassifications, salary information, evaluations, promotions, and terminations.	To determine if salary changes are properly authorized and justified, examine an employee's payroll/personnel file to determine if proper authorizations exist for the pay rate indicated on the payroll register.	Unauthorized adjustments may be processed to increase or decrease amounts paid to one or more employees.

Key Elements	Criteria	Aids in Evaluating Criteria	Risks
Labor Distribution	A record documenting charges of gross payroll expenses to accounts/funds/cost centers shall be maintained.	A payroll register should be maintained. The distribution of the gross pay for one pay period should be reviewed. Specifically, the following should be ensured. -There should be an efficient method for summarizing the charges to the appropriate expense accounts. The distribution should be on a standard journal entry form. -The distribution record should tie directly to the general ledger accounts. -The format should accommodate both fund and cost center accounting.	Inadequate labor distribution records may result in the improper allocation of payroll costs to funding sources.
(b) CONTROLLING PAYMENTS: Approvals	Salary and wage rates should be approved in writing by an authorized individual. Procedures must be adequate to provide that employees are paid in accordance with approved wage and salary plans.	Review the wage and salary plan. It should document the following: -Authorized rates or salary ranges by employee group, experience, etc.; -Frequency of payment; -Overtime policies, rates to be paid, etc.; -Eligibility for benefits and limits; -Benefit costs to be paid by employee; and -Policies related to employee advances and expense reimbursements.	Failure to approve or the absence of an appropriate wage and salary plan may result in: -Unauthorized payroll adjustments; -Excessive payroll adjustments; -Violation of minimum wage laws, union contracts, etc.; and -Uncollectible advances.
Adjustments	Any adjustments to payroll disbursements should be approved by an authorized individual independent of payroll preparation.	The wage and salary plan should contain a clear statement of criteria or policy related to payroll adjustments.	Failure to approve adjustments may result in unauthorized disbursements.
Check Signing	Payroll checks should be signed by persons independent of payroll preparation.	Review the canceled payroll checks for the prior month and verify that the person signing the checks had no part in preparing the payroll.	Lack of segregation of payroll duties provides opportunities for major and ongoing defalcations.

Key Elements	Criteria	Aids in Evaluating Criteria	Risks
Imprest Bank Account	Payrolls should be disbursed from an imprest bank account restricted for that purpose. Deposits to the payroll account should be controlled by an authorizing procedure which prevents duplicate deposits and over deposits.	Verify that there is a separate payroll bank account. Review the policies for cash deposits, withdrawals, and check preparation and ensure that they are understood and followed by responsible employees.	The lack of an imprest payroll account can facilitate unauthorized payroll transactions. Failure to control deposits as well as disbursements provides opportunities for defalcation.
Gross to Net to Employee	Employees should be furnished information on their gross earnings with their payroll checks.	The format for furnishing employees their payroll information should include an identification of each deduction.	Review of an employee's pay stub decreases the possibility for unauthorized deductions.
(c) TAX LAW Quarterly Withholding Report	Proper withholding and prompt payment of applicable federal, state and local income and payroll taxes should be evidenced by the quarterly withholding reports (Form 941).	Obtain the latest quarterly withholding reports for federal and state taxes to determine that they were filed on time and paid correctly.	A failure to collect and report tax withholdings in a timely manner may result in violation of law, fines and penalties.
3.5-6 <u>GENERAL JOURNAL</u>	There should be no direct entries to the general ledger. Every entry to the general ledger not originating from the cash receipts journal, payroll register/ labor distributions, cash disbursements journal or client trust subsidiary records or any other subsidiary record of original entry should initially be posted to the general journal.	Review the general journal for the criteria listed.	Posting of entries directly to the general ledger increases the possibility of inappropriate, unauthorized or unsupported entries.
Documentation	Each entry to the general journal should be: - fully described; - adequately documented; - sequentially numbered; and - approved by an authorized individual.	Examine the general ledger to ensure that all entries are referenced to where they originated. Examine the supporting documentation for several general journal entries for several different months. Verify that all entries were made consistent with the criteria.	Unsupported or poorly referenced entries are difficult to trace and make it difficult to detect irregularities, and may increase audit costs. Incomplete, inaccurate, or unsupported entries to the general ledger increase the possibility that the financial data may misrepresent the actual financial position of the recipient.
3-5.7 <u>CLIENT TRUST RECORDS</u> **(a) INDIVIDUAL BALANCE**	Each program shall establish a method to determine the balance for each client's account.	Review the client trust ledger cards or records to determine that individual client balances are maintained.	Accurate individual client trust balances as required by standards of professional legal practice are also essential in maintaining client and community relations.

Key Elements	Criteria	Aids in Evaluating Criteria	Risks
(b) GENERAL LEDGER CONTROL	The transactions of the client trust accounting system should be under general ledger control.	A recurring weakness, not always immediately obvious, is that although client funds are included in the general ledger, they may not be under general ledger control. Verify that the balance in the general ledger results from recording total receipts from clients and total disbursements for clients made during the month.	The legal profession is held to a high ethical standard of accountability when client funds are involved. Defaults, even if amounts involved are not material, with respect to the standard of accountability may subject the responsible attorney and the executive director to review by the local or state bar.
(c) RECONCILIATION	The total of the individual client funds held should be reconciled to the general ledger bank account balance and general ledger liability balance on a monthly basis.	Examine a monthly bank reconciliation in order to: -Determine that the individual client ledger cards have been added and agree with the bank reconciliation; -Trace the bank balance to the bank statement and book balance to the general ledger for one month; -Determine that any adjusting journal entries are properly supported; and -Determine how items that have been outstanding for over two months will be recorded and ultimately treated.	Delinquent or inaccurate reconciliation represents a lack of adequate control over financial transactions and increases the possibility that irregular transactions will be undetected, or accountability for client funds will be lost.
(d) DISBURSEMENTS: Separate Bank Account	A bank account shall be separately maintained for client funds. The controls over this account should be specific and clearly stated. Client funds may not be commingled with any other funds.	Verify that a separate bank account is used and that the criteria and policies concerning its use are documented.	The high volume of client trust cash transactions increase the risk that client funds may be diverted.
Prenumbered Checks	Prenumbered checks should be used for disbursements.	Review the disbursement register for proper recording of all check numbers.	The absence of prenumbered checks can result in the loss of control over the checking account.
Adequate Documentation	Documentation supporting the reason for each disbursement shall be contained in the files.	The source documents for cash disbursements shall be the voucher copies of the check or the client trust cash disbursement book. Each client disbursement shall be supported by a request from the case attorney or other documentation that substantiates the propriety of the disbursement.	Inadequate documentation and approval can result in unauthorized disbursements.

Key Elements	Criteria	Aids in Evaluating Criteria	Risks
(e) RECEIPTS Duplicate, Prenumbered	Prenumbered receipts shall be issued for all money received from clients. Accountability in the form of duplicate copies of the receipts issued should be maintained.	The source documents for receipts shall be the prenumbered client receipts. Specific persons shall be designated to issue receipts. Clients shall be advised of the individual who can receive cash. There shall also be documented procedures for receiving cash in and out of the office.	Failure to have prenumbered receipts can result in the misappropriation of client funds.
3-5.8 <u>GENERAL LEDGER</u>			
(a) PROCEDURES: Monthly	The general ledger shall be posted monthly.	Verify that there is a detailed closing schedule identifying due dates and the individuals responsible for various categories of journal entries.	Timely management reports are dependent upon a timely closing and reconciliation of errors.
Double-Entry Method	The general ledger should be maintained on a double-entry basis.	During the general ledger review determine that a double entry method is being used, and manual systems that all entries are made in ink.	Inadequate maintenance of the general ledger may weaken control over overall operations. Audit costs may also increase significantly.
(b) DESIGN: Fund Accounting/ Cost Center Accounting/ Functional Accounting	The general ledger design should accommodate fund accounting, and/or cost center accounting/ functional accounting and other financial requirements in accordance with the most expedient procedures in the circumstances. Fund accounting or cost center/functional accounting requirements (whichever are not incorporated into the general ledger) may be provided for outside of the general ledger.	Determine whether the general ledger and any subsystems are efficiently designed to accommodate fund accounting, and cost center/functional accounting.	The failure to fully incorporate fund accounting into the program's accounting system may result in an inability to document compliance with federal requirements. The reliability of management reports generated from sources other than the general ledger can be significantly impaired and the actual report preparation significantly more cumbersome.

Key Elements	Criteria	Aids in Evaluating Criteria	Risks
(c) CHART OF ACCOUNTS	The chart of accounts shall provide general ledger detail sufficient to easily generate needed management information.	Review the chart of accounts. It should be: -Documented with all valid accounts listed; and -Adequately detailed to provide needed management information. Procedures should also be established for requesting and approving changes in the chart of accounts.	A chart of accounts which lacks adequate detail can significantly increase the time necessary to review a particular situation, or compile needed information.
(d) CONTROL ELEMENTS: Monthly	A trial balance of the general ledger shall be prepared monthly, for both manual and computerized accounting systems.	Verify that a trial balance was prepared for each month.	Without a monthly trial balance there is no assurance that the double-entry system is working effectively.
In Balance	Any out of balance condition should be identified and corrected.	Perform a detailed review of one trial balance and determine whether it balances and agrees with ledger accounts. Determine whether the balance is documented by an adding machine tape or other addition check.	Computerized accounting software designed to preclude out-of-balance entries may not be fully effective, and may be susceptible to circumvention by sufficiently knowledgeable personnel. If the books are not balanced: -Errors or omissions may go undetected; -The financial position may be erroneously presented; and -Management reports may be inaccurate.
Format	The trial balance should facilitate the preparation of management reports.	Assess whether the trial balance (or the general ledger) is designed so that all required reports could be drawn from it without need to refer to other records or perform other analyses to determine actual amounts.	
Kept on File	All trial balances shall be kept on file until the audit for that fiscal year has been completed and the audit report issued.	Review and verify that such a file is maintained.	Audit costs may increase.
3-5.9 MANAGEMENT REPORTS			

Key Elements	Criteria	Aids in Evaluating Criteria	Risks
(a) USE OF REPORTS Timeliness	The director should receive a monthly management report within a prescribed number of days after month-end.	Policies, procedures, and responsibilities for all report preparation should be determined and documented in an accounting manual. A reasonable time estimate should also be identified. Verify that the reports were completed each month and on a timely basis.	Untimely management reports may result in erroneous decision-making on the part of management and the Governing Body.
Program Director Review and Approval	The director should use the monthly management reports to ensure that all program resources are used efficiently and effectively.	Discuss with the program director his or her use of the reports.	Irregularities that may be revealed through the review of monthly management reports may disclose improper transactions or unanticipated costs which might otherwise go unnoticed.
(b) TYPE OF REPORTS: Total Program Budget vs. Actual	A cumulative comparison of total actual expenses against total budgeted expenses should be prepared. Variances both over and under should be identified on the face of the report.	Review this monthly management report to evaluate whether the report contains the information as described for comparison of totals against budget.	The lack of such reports may allow budgetary problems to continue unnoticed.
Funding Source Budget vs. Actual	Special reports by funding source designed to meet grantor and internal reporting requirements should be prepared as required.	The review should verify that all grantor reporting requirements are met.	The failure to comply with funding source requirements can result in a reduction or loss of funding.
Cost Center Budget vs. Actual (Optional)	The monthly reporting package may be designed to facilitate cost center reporting. Both budgeted expenses and actual expenses should be identified on each report. The ability to account for costs by functions can evolve from cost center reporting.	Determine if cost center reporting is being used and that all cost center requirements for management and grant reporting purposes are being met. If cost center reporting is not being used, document management's reasons and alternate procedures to maintain cost center budgetary control.	A consolidated report lacks the detail necessary for proper analysis and control of cost center or program spending.
(c) REPORT PREPARATION Financial System Design	The accounting and financial reporting system shall be designed to facilitate management report preparation.	Determine if the system is designed to be flexible enough to meet funding source reporting requirements.	The preparation of management and funding source reporting may be more costly when the financial system is poorly designed. However, regardless of the system design, the preparation of a report should be reviewed periodically.

Key Elements	Criteria	Aids in Evaluating Criteria	Risks
Detail Available	The monthly management report should be sufficiently detailed.	If a detailed analysis of expense accounts is required to determine the reason for a significant over-expenditure of a budget category, the report may not be sufficiently detailed.	The lack of a detailed budget may result in unanticipated fund balances and deficits.
Commitments	A monthly management report should identify known commitments that would have a material effect on the amounts reflected in the reports.	The program should be cognizant of its future commitments.	The failure to identify known commitments on behalf of a program may result in the appearance of being under budget.
Allocations	Common expenses shall be allocated among the sources on the basis agreed to by the applicable funding organizations, and in the absence of approved methods the allocation should be fair, consistent, and in an equitable manner to the individual cost centers, and funds.	The allocation methodology should be reviewed and assessed as to whether it fairly represents the total cost of an activity.	The allocation of a cost to an activity must demonstrate the total cost of the activity that a funding source is financing.

Key Elements	Criteria	Aids in Evaluating Criteria	Risks
3-5.10 BUDGETING			
Process	The budgeting process should be organized, involve top management, and be closely tied to the goals and priority setting process of the recipient. The budget should be built from cost center/function and "rolled-up" to create the total budget. Schedules should document the assumptions made in arriving at the final cost center/functional budgets.	An overall evaluation of the budgeting area will require a review of the budget "process" as it relates to each of the criteria listed. The questions which should be answered include the following: -Did the budgeting process appear organized and effective? -Does the budget include carry-over funds or carry-over deficits? -Does the total "budget" or management report reflect funds expected to be received from all sources based upon the best information available? -Does the budget process and the accounting records accommodate the preparation of a budget by cost center, or does the recipient attempt to prepare a budget on a total program basis? -What is contained in detailed schedules that were used to develop the budget?	Budgeting and projecting are the key tools that should be utilized by management to adequately control and plan the expenditures of the program.
Format	The budget should be formatted to coincide with the format of the management reports. In addition, for budgeting purposes the chart of accounts should be sufficiently detailed to avoid extensive references to other sources of information or reclassification to determine the content of an account for budgeting or other management purposes.	-Is the budget based on cost center data? -Does the budget include all funds expected to be received during the fiscal year? -Are schedules available which identify the assumptions upon which the budget is based? -Are costs equitably allocated by source funds within cost centers? -Is the chart of accounts detailed enough to facilitate the budgeting process or does preparing a meaningful budget require extensive analysis of the accounts and reference to many other records?	

Key Elements	Criteria	Aids in Evaluating Criteria	Risks
3-5.11 PROJECTIONS	Budget projections shall be set and monitored carefully.	The process of reviewing projections and budgeting are the same. Review the program's budget projections to assess the elements identified below.	
Quarterly	A report comparing actual expenses against projected expenditures should be made at least quarterly during the fiscal year. The report should include the following for each line item: (1) total budget; (2) actual expenditure to date; (3) projected expenses remaining; (4) projected total expenses for year (5) and projected variance over (under) budget.	-Are projections prepared on a quarterly basis? -If any of the management reports reveal a large variation from budget, is there any evidence that management has recognized and taken the necessary steps to resolve the variation.	Infrequent projections can weaken control over spending and result in budgetary problems.
Built from Cost Centers/Functions	The projections should be built from cost centers/functions.	-Are the projections built from cost centers/functions?	Projections made centrally without adequate input from the cost center manager may result in incomplete information and a distortion of the projected financial condition of the recipient.
Assumptions	The projections should be supported by schedules that document the assumptions used to arrive at the projected amount.	-Are projections supported? If so, trace several projected amounts back to the original schedules.	Inadequate support for assumptions increases the possibility of errors. It also makes future analysis and improvement of projection techniques difficult.
3-5.12 ASSIGNED RESPONSIBILITY	The individual responsibility for the timeliness and accuracy of each report, ledger, journal, procedure, and form should be documented in the recipient's accounting manual.	Verify that responsibilities have been assigned and are carried out.	The failure to assign responsibilities may result in increased errors, a reduction in accountability, and in the untimely issuance of fiscal reports.
3-5.13 BONDING	All individuals who handle cash, sign checks, and/or have purchasing or other financial responsibilities or access to financial records and assets shall have fidelity insurance coverage.	Verify that the governing body has approved or ratified fidelity bond insurance coverage for all appropriate individuals in conformance with 45 CFR Part 1629.	Failure to maintain fidelity coverage may result in unrecoverable losses.
3-5.14 EDP CONTROLS	General controls apply to all computer processing carried out at a facility and are independent of specific applications. They relate to organization, system design, development, and modifications, and security.		

Organization	Management must take an active role in EDP functions.	Do EDP function receives continuing audit coverage? Are past audit recommendations followed-up? Are there adequate separation of duties within the EDP operation?	Without management review and control over EDP, functions and controls are readily subject to misuse.
System Design, Development, and Modification	Controls in this category are intended to insure that systems meet user needs, are developed economically, are thoroughly documented and tested, and contain appropriate internal controls.	Is there a formal approach for system development? Are users involved in the development of system requirements? Do standards exists for documenting different EDP functions? Are requests for modifications to existing programs documented and approved by appropriate management levels?	Proper procedures for system design, development and modification will increase the likelihood of irregular handling of EDP functions be discovered on a timely basis.
Security	These controls must provide assurances that computers and the data they contain are properly protected against theft, loss, unauthorized access, and natural disaster.	Is a periodic risk analysis performed and documented? Have responsibilities for computer security been formally assigned? Is access to the computer room controlled through the use of some physical device? Is responsibility for storing magnetic data clearly documented? Is there an emergency disaster prevention and recovery plan and is it tested periodically?	Without adequate security controls over the computers and the data they contain the organization could experience financial losses because of theft, fire, unauthorized access and natural disaster.

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APPENDIX I ILLUSTRATIVE FINANCIAL STATEMENTS AND NOTES TO THE FINANCIAL STATEMENTS

1. FINANCIAL STATEMENTS

The illustrative financial statements presented follow the accounting and reporting principles discussed in this Guide and are acceptable financial reporting formats for LSC recipients. Some variations from the illustrations may be appropriate, as long as the required disclosures elements are shown. LSC recommends a columnar, matrix format. The use of this format for the reporting of LSC support, revenue and expenses (grant activity) will allow the Corporation to make comparisons with budgeted amounts as well as accumulate regional or national data for the legal services network.

The following are required disclosures and/or presentations that must be shown on a recipient's financial statements in order to comply with this Guide and LSC financial reporting guidelines:

(1) Comparative financial statements with memorandum totals only for the prior year;

(2) Separate reporting of LSC net assets on the Statement of Financial Position (Balance Sheet); and

(3) Separate reporting of LSC grant activity on the Statement of Activity or in a supplemental schedule, which shows expenses charged to the LSC grant by natural expense classification along with separate reporting of PAI and other LSC grant or contract activity.

Included as illustrative examples are LSC grant activity reported in a Statement of Activity (Appendix IA) and in a Supplemental Schedule of Support, Revenue and Expenses and Changes in Net Assets for Legal Services Corporation grants (Appendix IB). LSC recommends consultation with the recipient's auditors on the proper financial statement reporting of LSC grant activity under this Guide and GAAP.

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APPENDIX IA

<u>(ILLUSTRATIVE)</u>

<u>FINANCIAL STATEMENTS FOR THE YEAR ENDED</u>

<u>DECEMBER 31, 19XX</u>

<u>WITH COMPARATIVE TOTALS FOR 19X-1</u>

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LEGAL SERVICES PROGRAM, INC.

STATEMENT OF FINANCIAL POSITION (BALANCE SHEET)

AS OF DECEMBER 31, 19XX, WITH COMPARATIVE TOTALS FOR 19X-1

ASSETS	19XX	19X-1
CURRENT ASSETS		
Cash	$ 36,290	$ 41,056
Certificate of Deposit	250,000	200,000
Client Escrow funds	3,100	2,500
Receivables	13,400	17,800
Prepaid Expenses	14,200	10,100
Total Current Assets	316,990	271,456
PROPERTY		
Furniture, Fixtures & Equipment	75,204	78,025
Accumulated Depreciation	(13,000)	(12,500)
Net	62,204	65,525
Leasehold Improvement	20,000	20,000
Accumulated Depreciation	(3,000)	(2,500)
Net	17,000	17,500
Law Library	20,000	18,000
Accumulated Depreciation	(4,000)	(3,000)
Net	16,000	15,000
Total Property	95,204	98,025
OTHER ASSETS		
Security Deposits	1,500	1,500
TOTAL ASSETS	$413,694	$370,981

LIABILITIES	19XX	19X-1
CURRENT LIABILITIES		
Accounts Payable	$ 40,180	$ 36,200
Accrued Expenses	37,200	32,100
Employee Withholding Payable	9,820	10,190
Client Trust Deposits	3,100	2,500
Current Maturities -- Notes Payable	6,948	5,689
Grants Payable	125,000	100,000
Total Current Liabilities	222,248	186,679
LONG-TERM LIABILITIES		
Notes Payable	14,311	20,000
Less current maturities	(6,948)	(5,689)
Total Long-term Liabilities	7,363	14,311
COMMITMENTS AND CONTINGENCIES		
NET ASSETS		
UNRESTRICTED	4,850	3,475
TEMPORARILY RESTRICTED		
Legal Services Corporation - grant	73,936	63,105
Legal Services Corporation - property	95,204	98,025
	169,140	161,130
Non-LSC	10,093	5,386
Total Temporarily Restricted	179,233	166,516
Total Net Assets	184,083	169,991
TOTAL LIABILITIES AND NET ASSETS	$413,694	$370,981

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

LEGAL SERVICES PROGRAM, INC.

STATEMENT OF ACTIVITY

YEAR ENDED DECEMBER 31, 19XX, WITH COMPARATIVE TOTALS FOR 19X-1

		TEMPORARILY RESTRICTED			19XX	19X-1
	UNRESTRICTED	**LSC**	**NON-LSC**	**TOTAL**	**TOTAL**	**TOTAL**
REVENUES AND OTHER SUPPORT:						
Grants and Contracts		$1,575,000	$328,000	$1,903,000	$1,903,000	$1,594,519
Donated Items	$50,000	125,000		125,000	175,000	135,000
Fees		3,000	11,631	14,631	14,631	7,500
Interest Income		3,488	714	4,202	4,202	3,895
Gain on Sale of Equipment		3,216		3,216	3,216	
Other	1,375				1,375	
Net assets released from:						
restrictions (Note ___):						
Satisfaction of program						
Restrictions	2,033,332	(1,697,694)	(335,638)	(2,033,332)		
Total revenues, gains						
and other support:	2,084,707	12,010	4,707	16,717	2,101,424	1,740,914
EXPENSES						
Program Services	1,902,174				1,902,174	1,530,616
Management and general	181,158				181,158	170,068
Total Expenses (Note __)	2,083,332				2,083,332	1,700,684
Return to LSC		4,000		4,000	4,000	
Total Expenses and Other	2,083,332	4,000		4,000	2,087,332	1,700,684
CHANGES IN NET ASSETS	1,375	8,010	4,707	12,717	14,092	40,230
Net assets at beginning of year	3,475	161,130	5,386	166,516	169,991	129,761
Net assets at end of year	$4,850	$169,140	$10,093	$179,233	$184,083	$169,991

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

LEGAL SERVICES PROGRAM , INC.
STATEMENT OF FUNCTIONAL EXPENSES
YEAR ENDED DECEMBER 31, 19XX

	PROGRAM SERVICES	MANAGEMENT AND GENERAL	TOTAL
PERSONNEL EXPENSES			
Lawyers	$628,958	$69,884	$698,842
Paralegals	298,145	33,127	331,272
Other	179,408	19,934	199,342
Employee Benefits	150,403	16,712	167,115
Total Personnel Costs	1,256,913	139,657	1,396,571
OTHER EXPENSES			
Space and Occupancy	230,478	25,609	256,087
Equipment Rental	6,587	732	7,319
Office Supplies and Expenses	26,829	2,981	29,810
Telephone	38,507	4,279	42,785
Travel	4,477	497	4,974
Training	9,272	1,030	10,302
Library	8,773	975	9,748
Insurance	23,306	2,590	25,896
Donated Services	175,000		175,000
Dues and Fees	1,391	155	1,546
Audit	8,172	908	9,080
Litigation	5,345	594	5,939
Contract Services to Clients	86,965		86,965
Contract Services to Program	9,786		9,786
Depreciation and amortization	9,230	1,026	10,256
Other	1,141	127	1,268
Total Non-Personnel	645,260	41,501	686,761
TOTAL EXPENSES	$1,902,174	$181,158	$2,083,332

The accompanying notes are an integral part of these financial statements

LEGAL SERVICES PROGRAM, INC.
STATEMENT OF CASH FLOWS
YEAR ENDED DECEMBER 31, 19XX, WITH COMPARATIVE TOTALS FOR 19X-1

Direct Method	19XX	19X-1
Cash flows from operating activities:		
Cash Received from grantors	XXXXXX	XXXXXX
Cash Collected on Receivables	XXXXXX	XXXXXX
Interest Income	XXXXXX	XXXXXX
Miscellaneous	XXXXXX	XXXXXX
Cash paid to employees and suppliers	XXXXXX	XXXXXX
Subgrants	XXXXXX	XXXXXX
Net Cash used by operating activities	XXXXXX	XXXXXX
Cash flows from investing activities:		
Purchase of equipment	XXXXXX	XXXXXX
Proceeds from sale of equipment	XXXXXX	XXXXXX
Net Cash used by investing activities	XXXXXX	XXXXXX
Cash flows from financing activities:		
Payment on notes payable	XXXXXX	XXXXXX
Loan Proceeds	XXXXXX	XXXXXX
Net Cash used by operating activities	XXXXXX	XXXXXX
Net Increase (Decrease) in cash and cash equivalents	XXXXXX	XXXXXX
Cash and cash equivalents at beginning of year	XXXXXX	XXXXXX
Cash and cash equivalents at end of year	XXXXXX	XXXXXX
Reconciliation of change in net assets to net cash used by operating activities:		
Changes in net assets	XXXXXX	XXXXXX
Adjustments to reconcile change in net assets to net cash used by operating activities:		
Depreciation	XXXXXX	XXXXXX
(Increase) Decrease in Client Trust Funds	XXXXXX	XXXXXX
(Increase) decrease in Receivables	XXXXXX	XXXXXX
(Increase) Decrease in Prepaid Expenses	XXXXXX	XXXXXX
(Increase) decrease in Other Assets	XXXXXX	XXXXXX
Increase (Decrease) in Accounts payable	XXXXXX	XXXXXX
Increase (Decrease) in Accrued Expenses	XXXXXX	XXXXXX
Increase (Decrease) in Client Trust Deposits	XXXXXX	XXXXXX
Increase (Decrease) in Grants Payable	XXXXXX	XXXXXX
Net Cash used by operating activities	XXXXXX	XXXXXX

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

LEGAL SERVICES PROGRAM, INC.
STATEMENT OF CASH FLOWS
YEAR ENDED DECEMBER 31, 19XX, WITH COMPARATIVE TOTALS FOR 19X-1

Indirect Method	19XX	19X-1
Cash flows from operating activities:		
Change in assets	$14,092	$xx,xxx
Adjustments to reconcile change in Net Assets to Net		
Cash used by operating activities:		
Depreciation	10,256	x,xxx
Funds returned to LSC	(4,000)	
(Increase) Decrease in Client Trust Funds	(600)	xxx
(Increase) decrease in Receivables	3,600	xxx
(Increase) decrease in Prepaid Expenses	(4,100)	(xxx)
Increase (Decrease in Accounts payable	3,980	x,xxx
Increase (Decrease) in Accrued Expenses	5,100	xxx
Increase (Decrease) in Client Trust Deposits	600	(x,xxx)
Increase (Decrease) in Grants Payable	25,000	x,xxx
Net Cash used by operating activities	53,928	xx,xxx
Cash flows from investing activities:		
Purchase of equipment	(7,486)	(xx,xxx)
Proceeds from sale of equipment	5,740	x,xxx
Net Cash used by investing activities	(1,746)	xx,xxx
Cash flows from financing activities:		
Payments on notes payable	(6,948)	(x,xxx)
Net Cash used by financing activities	(6,948)	(x,xxx)
Net Increase (Decrease) in cash and cash equivalents	45,234	xx,xxx
Cash and cash equivalents at beginning of year	244,156	xx,xxx
Cash and cash equivalents at the end of year	$289,390	$ xx,xxx

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

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SUPPLEMENTAL SCHEDULE OF SUPPORT, REVENUE,

EXPENSES AND CHANGES IN NET ASSETS

FOR LEGAL SERVICES CORPORATION GRANTS

FOR THE YEAR ENDED DECEMBER 31, 19XX, WITH

COMPARATIVE TOTALS FOR 19X-1

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LEGAL SERVICES PROGRAM, INC.

STATEMENT OF SUPPORT, REVENUE AND EXPENSES AND CHANGES IN NET ASSETS FOR LSC FUNDS

YEAR ENDED DECEMBER 31, 19XX, WITH COMPARATIVE TOTALS FOR 19X-1

	BASIC FIELD GRANT	PRIVATE ATTORNEY INVOLVEMENT	OTHER LSC GRANTS	TOTAL	PROPERTY	GRAND TOTAL	19X-1 TOTAL
SUPPORT AND REVENUE							
Grants and Contracts	$1,312,500	$187,500	$ 75,000	$1,575,000		$1,575,000	$1,465,000
Donated Items		125,000		125,000		125,000	100,000
Fees	3,000			3,000		3,000	
Interest Income	3,488			3,488		3,488	2,500
Gain on sale of equipment					$3,216	3,216	
Other							
Total	1,318,988	312,500	75,000	1,706,488	3,216	1,709,704	1,567,500
PERSONNEL EXPENSES							
Lawyers	512,169	45,012	42,911	600,092		600,092	560,090
Paralegals	253,286	19,523	2,063	274,872		274,872	270,820
Other	146,401	10,235	5,206	161,842		161,842	151,000
Employee Benefits	126,401	9,032	8,236	143,669		143,669	124,010
Total	1,038,257	83,802	58,416	1,180,475		1,180,475	1,105,920
OTHER EXPENSES:							
Space and Occupancy	155,783	10,648	2,156	168,587		168,587	160,280
Equipment Rental			6,069	6,069		6,069	6,520
Office Supplies and Expenses	22,559	1,502	3,218	27,279		27,279	28,020
Telephone	35,004	4,031		39,035		39,035	35,010
Travel	3,168	56		3,224		3,224	4,280
Training	4,698	893	1,141	6,732		6,732	6,280
Library	8,963			8,963		8,963	7,403
Insurance	15,023	1,023		16,046		16,046	15,050
Donated Services		125,000		125,000		125,000	100,000
Dues and Fees							700
Audit	6,000	580		6,580		6,580	6,860
Litigation	4,589			4,589		4,589	3,210
Contract Services to Client		84,965		84,965		84,965	81,430
Contract Services to Program	9,001			9,001		9,001	7,180
Depreciation & Amortization					10,256	10,256	9,582
Other	893			893		893	
Total	265,681	228,698	12,584	506,963	10,256	517,219	471,805
TOTAL EXPENSES	1,303,938	312,500	71,000	1,687,438	10,256	1,697,694	1,577,725
SUPPORT AND REVENUE OVER (UNDER) EXPENSES	15,050	0	4,000	19,050	(7,040)	12,010	(10,225)
CHANGES IN NET ASSETS:							
Acquisition of Property	(7,486)			(7,486)	7,486		
Note Payment	(5,689)			(5,689)	5,689		
Transfer of proceeds from	8,956			8,956	(8,956)		
Returned to LSC			(4,000)	(4,000)		(4,000)	
Net Other changes	(4,219)		(4,000)	(8,219)	4,219	(4,000)	
TOTAL CHANGES IN NETS ASSETS	10,831	0	0	10,831	(2,821)	8,010	(10,225)
NET ASSETS							
Beginning of Year	63,105			63,105	98,025	161,130	171,355
End of Year	$73,936	$0	$0	$73,936	$95,204	$169,140	$161,130

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2. NOTES TO THE FINANCIAL STATEMENTS

GAAP sets forth certain disclosures that should be included in a not-for-profit organization's financial statements. These notes are written to reflect LSC policies as realistically as possible. The appropriate disclosures required by GAAP must be made for each program individually. LSC recommends consultation with the recipient's auditor in this area. However, substantial deviation from suggested formats and disclosures may not satisfy LSC's annual financial reporting requirements. A description of each Note follows:

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(Note should include explanations of all the significant accounting policies used by the recipient. This note may contain some or all of the following: purpose, operation and legal form of the entity, management estimates, basis of financial statement presentations, capitalization of fixed assets and depreciation methods, cost allocations, cash and cash equivalent and/or policies on contributed/donated items and services.)

RESTRICTED NET ASSETS

(Note should report information about the nature and amounts of the different types of permanent restrictions and temporary restrictions on net assets along with the purposes of temporarily restricted and permanently restricted net assets. For fiscal year ends other than December 31st, this note should also enable LSC to identify the LSC temporarily restricted net asset balance pursuant to 45 CFR Part 1628 separately from LSC temporarily net assets designated for future periods.)

RECLASSIFICATIONS

(Note should include a schedule of those net assets (grant funds) released from grant and contract restrictions by incurring expenses satisfying the restricted purpose or by occurrence of other events specified by donors. This note should support the line item captioned "Net assets released from restrictions due to satisfaction of donor-imposed restrictions or any other line item that reclassifies temporarily restricted net assets to unrestricted.)

REVENUE RECOGNITION

(Note should include a description of each material support source, any restrictions on use of assets provided (contributions, total amount of funds available from executed grants/contracts, periods of funding covered by such grants/contracts, and a summary of funds expected to be received in the future (contributions receivable), and components of any grants payable reflected on the statement of financial position. If the number of sources is large, this information can be shown in a supplemental schedule or schedule of awards.)

EMPLOYEE BENEFIT PLANS

(Note should include a description of any pension plan or material benefits to employees and should be presented in accordance with GAAP. The note should also state whether the plans are qualified as tax-exempt by the Internal Revenue Service.)

LEASES

(Note should include a description of any capital lease arrangements included in Property and Equipment. A separate note should disclose any operating lease agreements including future minimum rental amounts for future periods.)

INVESTMENTS

(Note should describe how investments are valued and measured as well as a schedule of investment return shown in the Statement of Activities.)

COMMITMENTS AND/OR CONTINGENCIES

(Note should include but need not be limited to a description of any lawsuits or claims which could result in a material liability or any potential loss, description of any material contract or lease commitments which the recipient has entered into, and other commitments or contingencies of the recipient which should be disclosed in order to ensure the financial statements are not misleading, e.g., encumbrances.)

INCOME TAXES

(Note should include, but need not be limited to, a description of Federal and state tax status of the recipient, including private foundation status.)

PRIOR YEAR'S FINANCIAL INFORMATION

(The comparative financial statement format recommended in this Guide reflects totals only for the previous year's operations. Since comparative financial statements are considered necessary by LSC and not required but encouraged by GAAP, the following comment should be included in this note: "The financial statements include certain prior-year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with generally accepted accounting principles. Accordingly, such information should be read in conjunction with the organization's financial statements for the year ended (prior year), from which the summarized information was derived.")

NONRECURRING ITEMS

(Note should disclose any material item of support or expense which would not normally be expected to recur in the foreseeable future.)

RELATED PARTY TRANSACTIONS

(Note should disclose all financial transactions of the recipient with related parties such as directors, officers, subrecipients, and other organizations. Disclosure of subrecipient relationships may be more appropriately included in a note related to grants and contracts made during the year by the recipient or in a separate note.)

DONATED ITEMS/CONTRIBUTIONS

(Note should disclose all donated items received during the reporting period and describe the valuation method used and donor-imposed restrictions.)

DEBT

(Note should disclose all details of a Note Payable including amount, purpose, security, if applicable, monthly payment, interest rate and future maturities of the debt.)

PROPERTY AND EQUIPMENT

(Note should show full detail by asset category, including depreciation, for the amount shown as Property and Equipment.)

APPENDIX II DESCRIPTION OF ACCOUNTING RECORDS

This section describes the accounting records that shall be maintained by each recipient. In general, accounting records should be maintained on a double-entry method utilizing fund accounting. Each recipient should establish the system most appropriate to its needs. Each recipient shall retain original accounting records and supporting documentation per retention times for nonprofit records listed below, and make such records available for review when required.

General Ledger summarizes and classifies all financial transactions from data accumulated in the books of original entry. The general ledger is the final and permanent record of all of the recipient's financial transactions and basis for preparation of the financial statements.

Cash Receipts Journal records cash receipts (i.e., cash, checks, and money orders) in chronological sequence when received. Bank deposit slips must contain sufficient information so that all deposits can be traced to the original source and to the cash receipts journal.

Cash Receipts Log verifies the amount of cash receipts recorded in the general ledger and deposited in the bank. The log shall list the date the cash was received, payee, check number and amount.

Cash Disbursements Journal records disbursements in chronological sequence. All disbursements must be made by prenumbered checks (excluding petty cash funds) used in numerical sequence. Each check must be supported by appropriate documentation (e.g., payroll records, in voices, contracts, travel reports, etc.) as set forth in 45 CFR Part 1630. The approval of a disbursement by an authorized individual shall also be documented.

General Journal records those transactions that are not recorded originally in the cash receipts journal, cash disbursements journal, payroll register, or other books of original entry. Each journal entry must be adequately supported and documented. Journal entries or journal vouchers shall be numbered consecutively and approved by an authorized individual, such approval being evidenced by the authorized individual's initials and the date of review.

Payroll Records accumulate payroll data as required by Federal, state, and local laws. Documentation must be maintained to support individual gross earnings. The following payroll data shall be included in each employee's payroll file:

1. Wage or salary authorization, employment contracts, if applicable;
2. Federal W-4 withholding form;
3. State withholding form;
4. Authorization for all other payroll deductions; and
5. Authorization for all wage/salary actions.

Additionally, each recipient is required to establish an adequate time-reporting system. This system must be able to demonstrate the number of hours worked by an employee, including overtime and compensatory time earned. Whether a sign-up sheet, a time report, or other method is utilized, a supervisor in a position to verify the information, or an individual delegated by the supervisor, shall approve all time sheets.

Vacation and sick leave records must be maintained for each employee. These records shall identify the amount of vacation and sick leave earned and used and the remaining balances. The total of the remaining balance should support the amount disclosed in the financial statements.

Client Trust Records document the receipt and disbursement of client funds. The total of the balances of these individual records must equal: (1)the cash in the escrow bank account designated solely for client trust funds; and (2) the corresponding client trust liability account. Both accounts are required to be maintained in the general ledger and disclosed in the financial statements or in a note to the financial statements. Client names should not appear in the general ledger and should be substituted with assigned numbers (e.g., case file number).

Property Records account for fixed assets and equipment and should include, at a minimum, the following information:

1. A description of the property, including model and manufacturer's serial number or other identification number;
2. Date of acquisition;
3. Number of check used to pay for item;
4. Cost of the property and salvage value;
5. Useful life;
6. Depreciation method (i.e., recipient must either adopt a written policy on depreciation methods governing identifiable classes of property or show the actual depreciation method on each individual property record);
7. Source of funds used to acquire the property;
8. Description of how value was assigned if property was donated;
9. Location and condition of the property and the date the information was reported;
10. Inventory control number/tag;
11. The ultimate disposition data, including date and method of disposal and sales price if sold with the method used to determine the current fair value.

The total dollar value of individual items capitalized shall equal the property control account balance in the general ledger and support related amounts disclosed in the financial statements.

RETENTION TIMES FOR NONPROFIT RECORDS

LSC recommends consultation with the recipient's auditor or attorney to determine its record retention policies. Records that have continuing legal or tax significance should be retained.

Accounting Records

General journal	PERMANENT
General ledger	PERMANENT
Cash receipts book	10 years
Cash disbursements book	7 years
Bank statements and canceled checks	7 years
Billings for services	4 years
Employee travel and expense reports	4 years
Expense bills (source documents)	4 years
Petty cash records	4 years
Financial statements -- annual	PERMANENT
Financial statements -- monthly or quarterly	7 years

Fixed Assets

Land and buildings	PERMANENT

Equipment in use	KEEP ON FILE
Equipment traded in on similar asset	KEEP ON FILE
Equipment disposed of (no trade-in)	7 years
Contracts	
Leases (after termination)	7 years
Grant agreements	10 years
Restricted funds documentation (after use of funds)	10 years
Tax Returns	
Federal form 990 and working papers	PERMANENT
State information returns and working papers	PERMANENT
Payroll tax returns	5 years
Withholding tax statements (W-2)	7 years
Corporate Organization Records	PERMANENT
Corporate charter and certificate of incorporation	
Minutes of Board of Directors meetings	
Annual reports	
Personnel Records	
Individual employee records	PERMANENT
Payroll book	PERMANENT
Employee pension and insurance records	PERMANENT
General Correspondence	5 years

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APPENDIX III CHART OF ACCOUNTS

1. Overview

The chart of accounts lists the accounts in the general ledger that can be used to accumulate financial information necessary for adequate grant reporting for both internal and external purposes. The chart of accounts also demonstrates how fund or grant activity and cost center and/or functional activity can be accumulated for the various funding sources, cost centers and/or functions.

The following sample chart of accounts reflects an account structure for a medium-sized recipient. For an automated accounting system, the chart of accounts is the key element that drives the entire system. In a manual system, the design of the manual records is equally important in ensuring the system will meet the needs of the recipient.

This sample chart of accounts is for reference purposes only. It does not dictate the accounts and detail required of recipients, but is simply one method of addressing the accounting requirements of this Guide. While the account numbering system, account descriptions, and level of detail utilized by recipients should be designed to provide management reporting and financial disclosures specifically related to individual recipients, the techniques selected must also accommodate the reporting requirements of LSC.

2. Chart of Accounts Structure

The basic structure of this chart of accounts is diagramed below.

Fund

Natural Account Classification

Cost Center/Function (If required, this code can be expanded to accommodate both cost center and functional reporting.)

XX XXX XX/XX

The fund, natural account classification, and cost center/function coding logic is summarized as follows:

FUND	CLASSIFICATIONS	COST CENTERS	FUNCTION
01 LSC	100 Assets	11 Main Office	10 - Non Private Attorney Involvement
02 IOLTA	200 Liabilities	12 Downtown Office	20 - Private Attorney Involvement
03 AAA	300 Fund Balances	13 Rural Office	
04 Miscellaneous Grants and Contracts	400 Support		
	500 Expense		
05 Unrestricted/General Fund	600 Expenses (Cont’d)		
06 Donated Items	700 Asset Activity		

3. Sample Chart of Accounts

The coding logic described above, when used in conjunction with natural account classifications similar to those described below, provides extensive flexibility for accumulating financial information needs an d requirements.

ASSETS	LIABILITIES
100 Cash Accounts	200 Accounts Payable
101 Operating	201 Vendor
102 Payroll - Imprest	202 Employer FICA
103 Petty Cash - Imprest	203 Unemployment Compensation
	204 Group Health and Life
110 Client Trust Funds	205 Worker's Compensation
111 Main Office	
112 Downtown Office	
113 Rural Office	
120 Receivables:	210 Employees Withholdings Payable
121 LSC	211 Federal Income Tax
122 IOLTA	212 State Income Tax
123 AAA	213 FICA
124 Other	214 Group Health and Life
130 Investments	220 Accrued Expenses
131 Treasury Bills	221 Payroll
132 Certificate of Deposit	222 Other
140 Travel Advances to Employees	225 Grants Payable
150 Prepaid Expenses	230 Client Trust Deposits
151 Prepaid Insurance	
152 Deposits	235 Notes Payable
160 Furniture, Fixtures, and Equipment	FUND BALANCES (Net Assets)
170 Law Library	300 Restricted Grants and Contracts:
180 Leasehold Improvement	301 LSC
	302 IOLTA
190 Accumulated Depreciation	303 AAA
and Amortization	304 Miscellaneous Grants & Contracts
191 Furniture, fixtures,	
and Equipment	310 Unrestricted
192 Leasehold improvements	
	320 Property

SUPPORT AND REVENUE

400 Grant and Contract Support

410 Contributions - Cash

411 Bar Associations

412 Other

430 Interest Income

440 Court Awarded Attorney Fees

450 Miscellaneous and Other Revenue

EXPENSES

500 Lawyers' Salaries

510 Non-Lawyers' Salaries and Wages

520 Overtime wages

521 Overtime Lawyers

522 Overtime Non-Lawyers

530 Employee Benefits

531 Employees FICA

532 Group Benefit Insurance

533 Unemployment Insurance

534 Retirement Contributions

540 Legal Consultants/Judicare Payments

550 Other Consultants/Professional Services

551 Audit Expense

552 Other Accounting Services

553 Non-Legal Consultants

554 Membership Dues and Fees

560 Travel

561 Transportation

562 Lodging

563 Meals

564 Registration and Conference Fees

565 Local Travel

EXPENSES (Continued)

570 Space and Occupancy

571 Rent

572 Janitorial Service

573 Gas

574 Electric

575 Water

576 Hazard Insurance

580 Office Expenses

581 Supplies

582 Recruitment

583 Insurance

584 Postage

585 Reproduction

586 Telephone

587 Library

590 Litigation Costs

591 Depositions and Transcripts

592 Expert Witness

593 Filing, Docket and Service Fees

594 Printing of Briefs and Petitions

599 Interest Expense

600 Equipment Rental

610 Depreciation and Amortization

620 Subgrants Expense

700 Acquisition of Personal Property

705 Acquisition of Real Property

710 Acquisition of Library

720 Proceeds from Sale of Property

730 Gain or Loss on Sale of Property

4. Description of Accounts

The chart of accounts provides a method of organizing a recipient's accounting records. While a recipient's accounting system must be designed to suit its particular needs, these basic accounts descriptions should be considered in the development of the recipient's accounting system.

ASSETS

Cash - Operating -- cash on deposit in bank account(s).

Cash - Imprest Payroll Account -- used exclusively for the disbursement of payroll.

Petty Cash -- funds held at the recipient's office for paying small and emergency expenditures.

Client Trust Funds -- the receipt of funds on behalf of clients.

Investments -- the carrying value of investments, e.g., certificates of deposit, and treasury bills. A subsidiary record should be maintained for each class of investment to account for the cost and income.

Receivable(s) LSC or Other Grantors -- revenues earned but not received.

Receivable(s) - Other -- miscellaneous receivables.

Advances to Employees -- record the amount of travel advances outstanding. A subsidiary record or sub-account must be maintained for each employee.

Prepaid Expenses -- the amount of expenses paid which apply to future periods. A prepaid expense need not be recorded unless the expense applies to a period more than 12 months from the date paid.

Deposits -- amount of refundable deposits made by the recipient.

Furniture, Fixtures, and Equipment -- the cost (or fair value, if donated) of furniture, fixtures and equipment capitalized based on the recipient's policies.

Law Library -- the cost of the law library. The costs capitalized in this account should reflect only those items with a useful life of more than one year.

Leasehold Improvements -- the cost of all items valued in excess of $1,000, incurred in connection with making capital improvements to rental space (e.g., carpets, new walls, etc.), which cannot be carried to another location.

Accumulated Depreciation/Amortization -- the expiration of the service life of assets (i.e., periodic depreciation/amortization expense).

LIABILITIES

Accounts Payable --the amount of unpaid vendor invoices on hand. If accounting records are maintained on the accrual basis.

Other Accounts Payable --liabilities arising from the employer's share of employee benefits such as employer FICA, Unemployment Compensation, Workmen's Compensation, and other liabilities.

Employee Withholdings Payable --funds withheld from employees' salaries (e.g., FICA, federal, state and local taxes, pension, health insurance, etc.). Separate accounts should be maintained for each type of withholding.

Accrued Expenses -- the estimated cost of goods or services received for which an invoice has not yet been received. This account can be utilized at the close of an accounting period to accrue salaries, employer's share of FICA and other taxes, which are owed, but not yet paid. Separate accounts should be maintained for accrued salaries and other miscellaneous accruals such as utilities and consultant fees.

Grants Payable -- support received in advance, but designated to be used in a future period, or to record support received but not earned as of the date of the balance sheet, but is expected to be recognized as revenue in subsequent periods.

Client Trust Deposits --the amount of cash received from or on behalf of clients for court costs or other purposes. The balance must agree with the Client Trust bank account balance.

Net Assets (Fund Balance) -- an organization's net assets and are subject to review and approval by LSC. (45 CFR Part 1628) In addition, if LSC funding of a recipient is terminated, all unexpended LSC funds are to be returned to LSC or disposed of in accordance with instructions from LSC. Fund balances may be classified as "restricted" or "unrestricted." Restricted: These represent the balances of support over expenses for grants, contracts, and other awards which have restrictions. Each grant or contract or other award requiring separate reporting shall have a separate fund balance. Unrestricted: These represent the balances of support over expenses from unrestricted sources. Each contribution or other award requiring separate reporting shall have a separate account for its fund balance. Sound financial management practices should preclude deficit spending of unrestricted as well as other funds.

Property -- the net equity in all land, buildings, leasehold improvements, furniture, fixtures, equipment, and law books purchased.

SUPPORT AND REVENUE

Grants and Contracts -- the amount of support earned during the accounting period.

Contributions -- cash contributions received during the accounting period.

Donated Property and Services -- the value of all donated assets, facilities, and services received during the accounting period.

Interest Income -- interest earned during the accounting period.

Attorney Fees -- fees award received during the accounting period.

Miscellaneous and Other Revenue -- miscellaneous and other revenue earned during the accounting period which cannot be classified in any of the above accounts. Where amounts exceed $5,000, separate accounts shall be established to accurately describe the nature of the income.

EXPENSES

Salaries and Wages -- the salaries of all the recipient personnel. At a minimum, salaries shall be broken down into four main categories: attorneys, paralegals, support staff and other staff.

Employee Benefits -- the costs of items such as employer FICA taxes, unemployment taxes, employer retirement contributions, employer health and life insurance payments, workmen's compensation and other payroll-related benefit items offered by the recipient. Individual sub-accounts must be maintained for each of these items.

Contract Services to Clients -- payments to private attorneys and other consultants for service provided to clients.

Contract Services to Program -- the costs of contracted or purchased services. For financial statement purposes, other Consultant/Professional Services shall be described as to nature, amount and purpose.

Travel -- travel costs (e.g., transportation, lodging, and meal expenses while on a business trip).

Space and Occupancy -- the costs of rent, utilities (such as electricity, water, and gas), janitorial services, and hazard insurance.

Office Expenses -- the costs of, among other things, office supplies, printing, reproduction supplies, recruitment, postage, telephone, and insurance other than hazard insurance and employee benefit insurance.

Interest Expense -- interest paid pursuant to debt agreements.

Litigation Costs -- costs of depositions and transcripts, service of process, filing fees, expert witnesses, and any other litigation costs paid by the recipient and not by the client.

Equipment Rental -- all costs related to renting or leasing furniture and equipment.

Subgrant Expense -- all grants awarded to subrecipients by the recipient during the year.

Depreciation and Amortization -- the depreciation expense of furniture, equipment, law library and leasehold improvements acquired by the recipient.

PROPERTY ACCOUNTS

Acquisition of Personal Property, Real Property, or Law Library This account is used to record the costs of all land, buildings, furniture, equipment, leasehold improvements and other property or law books with a cost in excess of $1,000 that were purchased during the accounting period. The account is closed to the applicable fund balance of the source of funds used to purchase the property. This amount is the source for the entry to capitalize as assets all capital property purchases at year-end.

Proceeds from Sale of Property This account is used to record (as a closing entry) the proceeds from the sale of property in the appropriate fund and relieves the property fund balance of the related remaining original cost and/or gain.

Gain or Loss on Sale or Other Disposition of Property This account is used to record any gains or losses pursuant to the sale or other disposition of property.

APPENDIX IV ACCOUNTING FOR PROPERTY

1. OVERVIEW

LSC requires capitalization and depreciation of property and equipment. Capitalization provides balance sheet control over the asset. Depreciation recognizes that capital assets are a part of the ongoing cost of providing legal services.

Separate "asset acquisitions" accounts should be included in the chart of accounts to record property transactions. During the year, purchases are charged to this account based on the recipient's asset capitalization policy. LSC recommends that purchases over $1,000 with useful lives of more than one year be capitalized; however, recipients have the discretion of using lower values. Asset acquisitions are reflected in interim reports as expenses and at year-end the balance in the " asset acquisition" account is capitalized.

LSC does not require that the general ledger maintain property accounts balances by funding sources; accordingly the record of whose funds were used to purchase or finance particular items is included only in the property records. Recipient's property records can be individual cards or other documents that contain the information listed above in the section captioned "Property Records." Also, see Appendix II.

Accounting for the law library, which is part of property and equipment, does not require that depreciation be recognized when the estimated salvage value will equal or exceed cost. A particular volume should be written off when it becomes obsolete. Major additions to the law library should be capitalized. The ordinary cost of maintaining a law library, such as updates, replacements, periodicals, loose leafs, etc., should be charged to expense.

Depreciating assets should be a procedure that is the easiest and most reasonable for the recipient. Depreciation by individual item is the easiest method. Either the vintage year method, discussed later, or a lapsing schedule may be used. A lapsing schedule simply computes the asset's depreciation over its useful life when purchased. This depreciation is spread over the applicable years so that, for any one year, depreciation expense is taken directly from the schedule.

2. CAPITALIZATION

Capitalization of property items is illustrated in the following accounting entries that record the property acquisition using LSC funds. For illustrative purposes, the cost of the equipment is assumed to be $52,000 and the account names are from the chart of accounts illustrated in Appendix II.

Illustration 1.1 - To record equipment purchased with cash.

Dr: Acquisition of property	$52,000	
Cr: Cash		$52,000

To record the cost of property in a property acquisition account which will be closed to the appropriate fund balance at year-end.

For management reporting purposes, fixed asset purchases are treated as expenses during the year and closed to the appropriate fund balance as a reclassification along with all support and expense account at year-end.

Illustration 1.2 - A second entry is required (normally made quarterly or at the end of the year) to record the asset in a balance sheet account:

Dr: Furniture, Fixtures, Equipment	$52,000	
Cr: Fund Balance		$52,000

Illustration 2.1 - To record equipment financed partially by debt.

(a)	Dr: Acquisition of Property	$ 2,000	
	Dr: Furniture, Fixtures, Equipment	$50,000	
	Cr: Cash		$ 2,000
	Cr: Notes Payable		$50,000
(b)	Dr: Furniture, Fixtures, Equipment	$ 2,000	
	Cr: Fund Balance		$ 2,000

To record (a) the purchase of equipment costing $52,00 with a $2,000 cash down payment with th e balance financed by a $50,000 note. A second entry (b) similar to the second entry in illustration 1.2 is necessary to record the cash portion of the asset cost in the balance sheet account - Furniture, Fixtures and Equipment.

Illustration 2.2 - To record periodic payments on the note payable.

(a)	Dr: Acquisition of Property	$ 4,000	
	Dr: Interest Expense	$ 500	
	Cr: Cash		$ 4,500
(b)	Dr: Note Payable	$ 4,000	
	Cr: Fund Balance - Property		$ 4,000

To record (a) payment of debt ins tallment in the Acquisition of Property accounts (which will be closed to the applicable fun d balance) and the related interest expense; and (b) to record the increase in equity in the property fund resulting from payment on the Note Payable.

When a recipient has historically expensed property and such property is still in use, an entry t o capitalize these assets can be made by recording the furniture, fixtures, equipment or law library at its original cost less accumulated depreciation. In absence of accurate historical cost records, an appraisal or other estimate of the cost will be satisfactory. A cost-based appraisal contemplates recording property on the basis of catalog prices, vendor price lists, or another reasonable source. Each recipient should exercise judgment in using a reasonable method to determine an amount to be capitalized.

3. DEPRECIATION

LSC suggests that the straight-line depreciation method with the following g uidelines for estimated useful lives, or other criteria can be used if a recipient believes the criteria below are not appropriate for program' s assets.

Buildings	30 to 40 years
Furniture, fixtures, and equipment	5 to 10 years
Law Library	3 to 10 years
Leasehold Improvements	Term of lease or life of improvements whichever is shorter.

Using the earlier example, assuming a useful life of ten years, a salvage of $6,000 and depreciatio n computed on the straight-line met hod depreciation on the equipment for one year is $4,600 ($46,000 divided by 10) and would be recorded in the property fund as follows:

Dr: Depreciation and Amortization Expense $4,600

Cr: Accumulated Depreciation--Equipment $4,600

During the year of acquisition or disposal, the recipient should record one-half year's depreciation expense for convenience.

Depreciation may be computed on an item-by-item or group basis. The item-by-item basis is the simplest method. The group basis consolidates similar type items (i.e., - all furniture, all office equipment, etc.) purchased during a year (vintage-year) and considers them as one group (i.e., furniture, equipment, etc.). Therefore, depreciation records are maintained for the group instead of each individual item group.

A record detailing original cost of each item within the group should be maintained by year to be used if particular items are sold or retired before they are fully depreciated (this subject will be discussed later). Depreciation for groups of assets is computed in the same manner as depreciation for an individual item, which was illustrated in the previous paragraph.

4. SALES

The net gains or losses from the sale of property and equipment should be reported as revenue or expense in the class of net assets that purchased the property. Gain or loss on a transaction is defined as the difference between the sales proceeds and the net book value of the asset (original cost reduced by accumulated depreciation to the date of sale).

Proceeds from the sale of LSC property are not, as a general policy, required by LSC to be reinvested in property. Proceeds, if not reinvested in property, should be used for general program purposes. This will not result in a permanent increase in annualized funding requirements.

The following illustrates the recording of a sale when a gain (Illustration 1) is realized or a loss (Illustration 2) is incurred:

Illustration 1 - Sale of equipment at more than net book value.

Assumptions:
a. Equipment was originally purchased for $52,000.
b. At time of sale, accumulated depreciation was $46,000.
c. Asset was sold for $20,000.

Sales of assets can be recorded most conveniently by utilizing the following two entries.

1. The first entry is necessary to record the transaction when it occurs.

Dr: Cash $20,000

Dr: Accumulated Depreciation $46,000

Cr: Furniture, Fixtures, and Equipment $52,000

Cr: Gain on Sale of Property $14,000

To record the receipt of a cash payment for property sold, clear the related asset and accumulated depreciation accounts, and record the gain on the sale.

2. The second entry can be made as a closing entry monthly, quarterly, or at year-end.

Dr: Fund Balance - Property $20,000

Cr: Proceeds from Sale of Property $20,000

To relieve the property fund balance for the unadjusted original cost ($6,000) and gain ($14,000) being carried therein, and record the related proceeds from the sale in the LSC fund.

Illustration 2 - Sale of equipment at less than net book value.

Assumptions: Same as illustration 1 except that the equipment was sold for only $1,000.

1. Again, the first entry is necessary to record the transaction when it occurs.

Dr: Cash	$ 1,000	
Dr: Accumulated Depreciation	$46,000	
Dr: Loss on Sale of Property	$ 5,000	
Cr: Furniture, Fixtures, and Equipment		$52,000

To record the receipt of a cash payment for property sold, clear the related asset and accumulated depreciation accounts, and record the loss on the sale.

2. The second entry again can be made as a closing entry monthly, quarterly, or at year-end.

Dr: Fund Balance - Property	$ 1,000	
Cr: Proceeds from Sale of Property		$ 1,000

To relieve the property fund balance for the remaining unadjusted original cost ($1,000) and record the proceeds from the sale in the LSC fund.

5. VINTAGE-YEAR ADJUSTMENT

When the group (vintage-year) method is used, gains or losses are recorded similarly. If an item is included in a group being depreciated over ten years, and four years depreciation has been recorded at the time of the sale, then the basis (i.e., cost less accumulated depreciation) for the item is 6/10 of its historical cost.

It should be noted that when an item is removed from a "group" account, the annual depreciation of that group must be adjusted for the item deleted. For example, assume a group originally consisted of ten items costing $1,000 in total and depreciated over ten years (depreciation expense is $100 per year). If one item costing $100 was sold after five years (50% of useful life) the computation of subsequent years' depreciation would be as follows:

Cost of remaining property ($1,000 - $100) = $900

Divided by useful life of 10 years = $90 annual depreciation

6. WRITE-OFFS

Amounts required to be written off through abandonment or the loss should be recognized as expense in the property and equipment fund. The following illustrates the write-off of equipment originally costing $52,000 with accumulated depreciation of $46,000 at date of abandonment:

Dr: Loss on abandonment of equipment	$ 6,000	
Dr: Accumulated Depreciation - Furniture, Fixtures, and Equipment	$46,000	
Cr: Furniture, Fixtures and Equipment		$52,000

APPENDIX V ACCOUNTING FOR CLIENT TRUST FUNDS

1. Overview

The fiduciary responsibility that a program has for client funds requires that accounting procedures used result in timely and accurate accounting. Manual or automated record systems may be used, provided controls and data described below are available.

Client funds must be deposited in a separate bank account designated only for that purpose and not commingled with the program's operating funds. Additionally, a client trust accounting system must include procedures that allow for:

1. Documenting the receipt of a client's funds
2. Documenting the disbursement of a client's funds and,
3. Ascertaining at any time each client's balance held in trust

2. Procedure

Client trust accounting begins with the receipt of the client's funds at the receiving unit (i.e., local office) where a client trust receipt form is prepared. When properly prepared, this form contains all information applicable to the receipt (i.e., client name, case number, whether payment was cash, check or money order, amount received, and purpose for which the money is to be used.) The client is given a copy of the receipt as well as the case attorney. Funds are deposited at least weekly in the client trust checking account.

Disbursement of client funds involves the preparation of a check requisition and a three-part trust voucher. The check requisition is initiated by the case attorney and provides all information necessary to prepare a check and properly record the disbursement against the appropriate client's balance. The individual responsible for preparing the check must review the active client trust file to ascertain that sufficient funds have been collected previously from the client before approving the disbursement. The original check will be disbursed to the payee, a copy should be given to the case attorney for the client file and the third copy will be maintained in accounting.

When a client's funds have been completely disbursed (i.e., the balance is zero) and the account marked "closed," it should be removed from the active file and placed in order in an inactive file. The recipient's Governing Body should establish a policy for the period the inactive file should be retained in accordance with guidelines established by the local or state bar association or state escheats laws. Normally, there is no need to retain this file more than five years.

At month's end, a reconciliation of client balances must be made. The total of client accounts must equal the reconciled cash balance in the checking account. The general ledger client trust cash account and client trust liability account should have monthly journal entries to account for any activity.

The client trust procedures should provide for periodically reporting on client trust balances which have been inactive for a long period. This report is distributed to all program attorneys. The appropriate case attorneys should comment on the status and indicate if any follow-up is needed to return the funds to the client. Where a case is closed and the client can not be located, programs should follow state escheat regulations to forward funds to the state.

Client trust accounts are not intended to be used when a program pays a client's court costs and expects to be reimbursed later. In this situation, a regular program check should be used instead of the Trust voucher check and a receivable from the client recorded in the amount of the disbursement. If it is subsequently determined that the client will not reimburse the program in full, the remaining receivable balance should be charged to litigation expense.

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APPENDIX VI OTHER REGULATORY FINANCIAL REQUIREMENTS

1. Tax Reporting

Not-for-profit organizations, such as most LSC recipients, are exempted from various federal, state and local taxes. However, they are required to file a number of tax returns and provide information about their activities to governmental bodies. These informational returns substantiate the organization's right to exemption from the various taxes. They also are used to determine tax liability for unrelated business income and other purposes.

All organizations exempt from tax under Internal Revenue Code (IRC) are required to file certain tax and information returns. A tax-exempt organization's filing requirements vary depending on the nature of the organization, its purpose and its activities.

Below is a list of tax and information returns which could be required. For specific details on applicable due dates and filing requirements, the IRC, applicable instructions for the form and/or related tax publications should be referenced. Consultation with the recipient's auditor will also be helpful.

<u>Federal Forms</u>:

Form 990	Return of Organization Exempt from Income Tax
Schedule A	Supplementary Information to Form 990
Form 8282	Donee Information Return used by the original and successor donee organizations who sell, exchange, consume, or otherwise dispose of charitable property within two years after the original donee received the property.
Form 990T	Exempt Organization Business Income Tax Return for organizations with gross income of $10,000 or more from an unrelated trade or business.

<u>State Forms</u>: Currently, with the exceptions of Delaware, Kentucky, South Carolina, Texas and Wyoming, every state and the District of Columbia require the filing of some tax form by tax exempt organizations. Recipients should determine what forms are required for their particular state and organization.

2. Payroll and Miscellaneous Requirements

All organizations are required to file government forms related to the employment of personnel and withholding of taxes. Specific reports and forms, some informational and others requiring the payment of taxes upon filing, must be timely filed with appropriate governmental federal and state agencies. In addition to federal requirements, state and local requirements may apply. Penalties may be associated with late filings. Pervasive noncompliance could result in criminal penalties being assessed, in addition to monetary fines and interest.

An employer is required to maintain, use and/or file some or all of the following Internal Revenue Service (IRS) employment forms and tax returns:

SS-4	Application for Employer Identification Number
I-9	Employment Eligibility Verification
W-4	Employee Federal Withholding Allowance
8109	Federal Tax Deposit Coupon
941	Employer's Quarterly Federal Tax Return
941M	Employer's Monthly Federal Tax Return
945	Annual Return of Withheld Income Tax
945-A	Annual Record of Federal Tax Liability
940	Employer's Annual Federal Unemployment Tax Return
941C	Supporting Statement to Correct Information
W-2	Annual Wage and Tax Statement
W-2C	Statement of Corrected Income and Tax Amounts
1099-MISC.	Statement for Recipients of Miscellaneous Income
1096	Annual Summary and Transmittal of U.S. Information Returns
843	Claim for Refund and Request for Abatement
W-3	Transmittal of Wage and Tax Statement
W-3C	Transmittal of Corrected Wage and Tax Statement
8809	Request for Extension of Time to File
1099R	Distribution from Pension, Annuities, Retirement, IRA's, Insurance Contracts, etc.
W-4P	Withholding Certificate for Pension or Annuity Payments

Miscellaneous filings related to charitable contributions and the disposition of donated property require the following forms be filed:

Written Substantiation acknowledging the contribution of $250 or more for Donors wishing to claim charitable tax deductions; and

8282 Donee Information Return for Sale, Exchange, or Other Disposition of Donated Property.

3. Office of Management of Budget

Not-for-Profit Organizations that receive Non-LSC federal financial assistance also must follow cost and administrative requirements created by the Office of Management and Budget, the Cost Accounting Standards Board, and the federal agencies from which the not-for-profit organization receives its funds. The requirement standards for entities receiving governmental financial assistance are contained in a variety of pronouncements. The following is a list of circulars issued by OMB that apply to not-for-profit organizations:

- A-133 Audits of Institutions of Higher Education and Other Non-Profit Institutions
- A-122 Cost Principles for Non-Profit Organizations
- A-21 Cost Principles for Educational Institutions
- A-110 Uniform Administrative Requirements for Grants and Cooperative Agreements with Institutions of Higher Education, Hospitals and Other Non-Profit Organizations.

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APPENDIX VII ACCOUNTING PROCEDURES AND INTERNAL CONTROL CHECKLIST

The essence of an effective system of internal control is the segregation of duties in such a way that the persons responsible for the custody of assets and conduct of operations have no part in the keeping of, and do not have access to, the records which establish accounting control over the assets and the operations. Duties of individuals should be so divided as to minimize the possibility of collusion, perpetration of irregularities, and falsification of the accounts. The objective is to provide the maximum safeguards practicable in the circumstances, giving due consideration to the risks involved and the cost of maintaining the controls.

The following checklist is provided as a guideline for recipient's management to direct attention to practicable revisions of accounting procedures or internal controls which can be made to strengthen, improve, or simplify the existing system. This checklist should not be considered all-inclusive nor are all items considered necessary for all recipients. This is an area where recipients should utilize the expertise of their auditors in a continuing relationship to maximize the services an auditor can provide. The items marked with an asterisk (*) are considered fundamental and essential elements of internal controls. There should be few legitimate reasons not to include these as part of each recipient's procedures.

A. GENERAL

*1. Has a system of authorizations and approval been established to require appropriate managerial approval for all significant actions or financial transactions of the organization?

*2. Has a chart of accounts been established to identify all accounts in the accounting system?

*3. Does the organization use a double-entry accounting system?

*4. Are transactions in the accounting records properly authorized, as evidenced by supporting documentation containing the appropriate approving official's signature?

*5. Are bank accounts authorized by the Governing Body?

*6. Are employees and officers who handle assets or perform significant financial duties bonded?

*7. Are budget controls established to allow the program director to adequately control expenditures?

*8. Are procedures established to provide a clean cutoff between periods with respect to the recording of support and expenses?

9. Has a general policy with respect to insurance coverage been defined and procedures instituted to insure that all significant business risks have been covered? Is insurance coverage periodically reviewed with a competent insurance agent?

*10. Are journal entries adequately explained, supported, and approved by a responsible officer or employee?

11. Does the recipient prepare and use an annual overall financial plan or operating budget to allocate its resources and provide a system of evaluation and control?

12. Does the recipient have an accounting and financial manual that stipulates the financial duties of employees?

13. Is there an organization chart to show definite lines of responsibility and authority?

14. Are employees required to take annual vacations, and are duties assigned to others in the absence of an employee on vacation or otherwise absent?

15. Are the accounting policies followed by the organization in agreement with those stipulated by their grants and contracts?

16. Where feasible, are common or indirect costs accumulated into cost pools for later allocation of costs to each project, contract, and grant?

17. Are bases used to allocate cost pools equitable and approved by the various funding organizations?

B. PERSONNEL AND PAYROLL

*1. Are salary and wage rates approved by a responsible officer in writing and are procedures adequate to provide that employees are paid in accordance with approved budget, wage, or salary rates?

*2. Do procedures provide for the proper withholding and payment of applicable federal, state, and local income and payroll taxes?

3. Are employees furnished information as to their earnings, deductions from earnings, etc., on their payroll check stubs?

4. When employees are initially hired, do procedures provide for reference checks and confirmation of prior salary and employment data, and is documentation made of these procedures and maintained as part of the employees' files?

5. Are payroll checks signed by persons having no part in preparing the payroll?

6. Are there personnel policies prohibiting employment of individuals which could result in nepotism or conflict of interest?

7. Are the payroll bank accounts reconciled by employees who have no other functions with respect to the payrolls?

8. Do procedures followed in reconciling payroll bank accounts include the checking of names on pay checks against payroll records and the examination of endorsements on checks?

*9. Is the reconciliation reviewed critically each month by an officer or responsible employee?

10. Is an independent test made of hours, rates, or other bases of payment by reference to attendance records, employment authorizations, approved rate changes, etc. by someone not connected with the preparation or distribution of the payroll?

11. Are personnel policies established in writing?

*12. Are employees' hours worked approved by the employees' supervisor?

*13. Are records kept on personnel actions including hiring, promotion, dismissal, and resignation of both full-time and part-time employees?

14. Are labor hours charged (distributed) to projects, contracts, and grants based on time distribution records, which identify the total time actually spent by all individuals who charged time directly to projects, contracts, and grants?

15. Are payroll totals checked against labor distribution totals which are compiled from the original time records?

*16. Are payrolls disbursed from an imprest bank account restricted for that purpose?

*17. Do the personnel and/or payroll records include the following or similar records:

    a. An attendance record?

    b. Vacation, sick and other excused leave records?

    c. Individual payroll record form?

    d. A payroll register?

    e. Notification concerning appointments, terminations, position classifications, and salary rates?

18. When employees work overtime, are there procedures to provide for (where applicable):

    a. Authorizing and paying overtime only to employees entitled to receive overtime pay?

    b. Recording earned and used compensatory time in lieu of overtime pay?

19. Where duties require employees to spend time away from their offices, do they prepare reports disclosing their weekly or monthly activities?

20. Are duties of those preparing the payroll rotated?

*21. Is a "tax return calendar" or other method used to insure timely preparation and filing of various payroll tax returns?

C. PROPERTY CONTROL

*1. Are records maintained for fixed assets purchased in excess of $1,000 which provide the following information

    a. Date of purchase?

    b. Description of item, including model and serial number?

    c. Cost and salvage value, if any, of item and check number of disbursement?

    d. Identification of funds used to purchase assets?

    e. Depreciation lives assigned to assets?

    f. Identification number and location of asset?

*2. Are fixed-asset records for items with a cost in excess of the capitalization limit balanced to the general ledger control accounts periodically?

*3. Are fixed assets tagged for easy identification with fixed asset records?

*4. Are physical inventories taken at least once every two years and compared to fixed asset records?

*5. Are adjustments (including adjustments resulting from theft, retirement and sale of assets) to fixed-asset records and general ledger control accounts reviewed and approved by an appropriate organization employee or officer who does not have responsibility for maintaining fixed-asset records?

D. PROCUREMENT

1. Are supplies in storage reasonably protected from theft, deterioration and damage?

2. Do procedures provide for the solicitation of prices for purchase, rent, and/or lease of fixed assets?

3. Do procedures provide that consideration will be given to the cost advantages of buying versus renting equipment and other nonexpendable property?

4. Are approved vendor lists used for recurring purchases?

*5. Does the recipient have a systematic method for determining what supplies are needed and in what quantities?

6. Are prenumbered purchase orders used and appropriate authorization obtained prior to purchase, rent, or lease of equipment and supplies?

7. Are receiving documents prepared (e.g., receiving log or ticket) and inspection of goods made without reference to purchase orders?

8. Are invoices, purchase orders and receiving documents compared and accounted for by a person not having any other purchase or receiving functions?

9. Are purchase orders outstanding for long periods of time investigated?

E. LEGAL CONSULTANTS/CONTRACT SERVICES

*1. Are procedures in effect to provide for formal approval by LSC, the governing body, or other high level authority, of consultant and contract service agreements over prescribed limits?

*2. Are there adequate procedures to insure that all necessary funding source approvals are obtained prior to entering into contracts?

3. Do procedures provide for the solicitation of proposals or bids prior to contract award?

*4. Are contracts written so that the services to be rendered are clearly defined?

5. Does the organization have controls for determining whether contracts are properly executed?

F. TRAVEL

*1 Does the organization have formal written travel policies?

*2. Is adequate support (e.g., lodging receipts, air fare tickets) received from an employee before reimbursement for travel expenses is made?

*3. Are there adequate controls over the accounting for advances and reimbursements for travel expenses made to employees?

4. For out-of-town travel, do employees prepare trip reports documenting the reasons and/or the results of the trip?

G. CONTROLS OVER CASH DISBURSEMENTS

*1. Are all checks prenumbered?

*2. Are all payments, except those made from petty cash, made by check?

*3. Are persons who sign checks designated by the governing body?

*4. When checks (except payroll) are presented for signatures, are the supporting vouchers and invoices also presented?

*5. Are there appropriate controls to assure that payments are made only for allowable items of costs, as defined by the terms of the respective contracts and grants?

*6. Are there procedures to insure that checks are never drawn payable to:

a. Officers or employees with the understanding that the cash is to be used for organization purposes (other than for travel reimbursements, petty cash reimbursements, etc.)?

b. Cash, bearer, or similar payee which renders the check payable to bearer?

c. Other payee when the payee named is not intended as the party to retain the funds?

7. Are written accounting policies and procedures established to describe the accounting system and assure that similar transactions are processed consistently?

*8. Are there procedures to insure that blank checks are never signed in advance?

*9. Have there been procedures adopted to insure that the names of individuals once authorized as check signers are not retained in the signature lists on file with the banks after the individuals have left the employ of the recipient or have been transferred to duties incompatible with check signing?

*10. Is there an appropriate system for filing checks, check copies, and supporting documents; and are supporting documents filed in such a manner so as to be readily located?

11. Are supporting documents marked paid or otherwise canceled and the check number and date of payment indicated to prevent duplicate payments?

12. Is a check protector used?

13. Where a mechanical check signer is used, is the signature die under adequate control?

H. CONTROLS OVER CASH RECEIPTS

*1. Are cash receipts deposited currently and intact?

*2. Does the accounting system identify the receipt and expenditure of program funds separately for each contract and grant requiring separate reporting?

3. Are bank-stamped duplicate deposit slips compared with the Cash Receipts Journal?

*4. Does the employee who opens the mail list the receipts in detail in the cash receipts log and is this record used by someone independent of other accounting functions to verify the amount recorded in the general ledger and deposited in the bank?

I. BANK RECONCILIATION PROCEDURES

*1. Are bank accounts reconciled monthly?

2. Does the reconciliation procedure include:

    *a. Comparison of checks with cashbook as to number, date, payee, and amount?

    b. Examination of signatures and endorsements, and procedures for the return of inadequately endorsed checks, paid by banks, to the banks for proper endorsements?

    *c. Examination of voided checks?

    *d. Accounting for serial numbers of checks?

    e. Comparison of dates and amounts of daily deposits as shown by the cash receipts records with the bank statements?

    f. Test-check of details shown on authenticated duplicate deposit slips obtained directly from the banks against the corresponding details in the cash receipts records?

*3. Are bank statements and paid checks delivered unopened directly to the person preparing the reconciliation or management official for review prior to the reconciliation?

J. SEGREGATION OF DUTIES

1. Do the bookkeeper's duties exclude the following functions:

    a. Receive cash or checks?

    b. Open the incoming mail?

    c. Prepare bank deposits?

    d. Sign checks?

2. Does an individual other than the person who prepares the bank deposit slip actually deposit the cash in the bank?

3. Is the mail opened by a person who does not prepare the bank deposit?

4. Do the duties of the person preparing the bank reconciliation exclude:

    a. Posting to the books of account?

b. Handling cash?

c. Signing checks?

5. Are checks, after being signed, controlled and mailed out by an individual who does not have any other accounting duties?

K. PETTY CASH CONTROLS

*1. Is responsibility for the petty cash fund vested in only one person?

*2. Are petty cash vouchers:

a. Required for each petty cash disbursement?

b. Signed by the recipient of the cash disbursed?

c. Executed in ink?

d. Approved by a responsible person?

*3. Are petty cash disbursements evidenced by properly approved supporting data?

*4. Are supporting data for petty cash disbursements checked at time of reimbursement?

*5. Are petty cash reimbursements made payable directly to the petty cash custodian by name rather than to cash, bearer, etc.?

*6. Are petty cash funds maintained on an imprest basis?

*7. Are there procedures to insure that the cash receipts are not commingled with the petty cash fund?

8. When the petty cash fund is reimbursed, is a notation of payment made on supporting data to prevent duplicate payment?

9. Is the petty cash bank account reconciled by an employee independent of the petty cash custodian?

10. Are petty cash funds audited by surprise counts by an independent person to insure the fund does not include personal checks, IOU's, etc., and that the petty cash fund balances?

L. CLIENT DEPOSITS CONTROLS

*1. Are client funds deposited into a bank account used only for the client's intended purpose?

*2. Was the client trust bank account approved by the governing body?

3. Are two signatures required on checks?

4. Is the account reconciled by an individual not involved with client deposit operations?

*5. Are prenumbered receipts given to clients for all checks and cash received?

*6. Are the following records maintained for the accounts?

a. A receipts book with pre-numbered receipts.

b. A cash disbursements journal.

c. A detailed record of the activity for each client's deposit.

APPENDIX VIII CORPORATION REGULATIONS SETTING ACCOUNTING POLICES

A. SUMMARY OF REGULATORY ACCOUNTING POLICIES

45 CFR § 1610.9: **Accounting**

Under this section of Part 1610 -- Use of Non-LSC Funds, Transfers of LSC Funds, Program Integrity, funds received by a recipient from a source other than the Corporation shall be accounted for as separate and distinct receipts and disbursements in a manner directed by the Corporation. The Corporation requires that such funds be reported separately from LSC funds in the annual financial statements.

45 CFR Part 1614: Private Attorney Involvement

§ 1614.3(e) is the relevant portion of this regulation. It states that the recipient shall demonstrate compliance with this Part by utilizing financial systems and procedures and maintaining supporting documentation to identify and account separately for costs related to the PAI effort. The financial systems should include the characteristics set out below:

i) They shall accurately identify and account for administrative, overhead, staff, and support costs related to PAI activities. Non-personnel costs shall be allocated on the basis of reasonable operating data. All methods of allocating common costs shall be clearly documented. If any direct or indirect time of staff attorneys or paralegal is to be allocated as a cost to PAI, such costs must be documented by time sheets accounting for the time those employees have spent on PAI activities. The timekeeping requirement does not apply to such employees as receptionists, secretaries, intake personnel or bookkeepers; however, personnel cost allocations for non-attorney or non-paralegal staff should be based on other reasonable operating data which is clearly documented.

ii)For payments to private attorneys for support or direct client services rendered, the recipient shall maintain contracts on file which set forth payment systems, hourly rates, and maximum allowable fees. Bills and/or invoices from private attorneys shall be submitted before payments are made. Encumbrances shall not be included in calculating whether a recipient has met the requirement of this part;

(iii)With regard to contractual payments to individuals or organizations that undertake administrative, support, and/or direct services to eligible clients on behalf of the recipient consistent with the provisions of this part, contracts concerning the transfer of LSC funds for PAI activities shall require that such funds be accounted for by the recipient in accordance with LSC guidelines, including the requirements of the Accounting Guide for Recipients and **45 CFR Part 1627.** Other such actual costs as may be incurred by the recipient in this regard.

(iv) Support and expenses relating to the PAI effort must be reported separately in the recipient's year-end audit. This shall be done by providing a supplemental schedule to the financial statement or a column within the financial statement reporting on grant activity which accounts for the entire PAI allocation. Recipients are not required to establish separate bank accounts to segregate funds allocated to PAI. Auditors are required to perform sufficient audit tests to enable them to render an opinion on the recipient's compliance with the requirements of this part.

45 CFR Part 1627: Subgrants and Membership Fees or Dues

§ 1627.3(c) is the relevant portion for the accounting requirements of this part. The recipient is responsible for ensuring the proper expenditure, accounting for, and audit of delegated (subgranted) funds. All subgranted funds shall be subject to the audit and financial requirements of this Guide and LSC's Audit Guide. Revenue and expenses related to subgranted funds must be separately disclosed either in the recipient's financial statements or the audited financial statements submitted by the subrecipient.

45 CFR Part 1628: Recipient Fund Balances

§ 1628.2 defines LSC Support as the annualized LSC grant award(s), plus any additional income derived from an LSC grant (interest, rents, etc.), plus the proportion of any reimbursement or recovery of direct payments to attorneys, proceeds from the sale of assets or any income attributable to any LSC grant. This section also states that a recipient's fund balance shall be determined solely by reference to the recipient's annual audit and provides the basis for calculating the fund balance percentage.

§§ 1628.3(e) and 1628.4(e) outline the accounting requirements. **§ 1628.3(e)** states that revenue and expenses relating to **one-time grants** must be reported separately in the annual audit. This may be done by providing a supplemental schedule of related revenue and expenses or a separate column within the financial statement reporting on grant activities. **§ 1628.4(e**), which addresses reporting for excess fund balances that have been approved for expenditure (fund balance waivers), has exactly the same reporting requirements as those described above for one-time grants.

45 CFR Part 1629: Bonding of Recipients

Under this part, all LSC recipients are required to carry fidelity bond coverage at a minimum of ten percent of the program's annualized LSC funding level for the previous year or of the initial grant if the program is a new grantee. In any event, the coverage cannot be less than $50,000.

§ 1629.2 states that every director, officer, employee and agent of the program who handles funds or property of the program shall be bonded as provided under this part.

§ 1629.3 defines "handles" for purposes of this regulation.

45 CFR Part 1630: Costs Standards and Procedures

This part provides uniform standards for allowability of costs and a comprehensive process for the resolution of questioned costs by recipients. **§ 1630.2** gives the definition of a "questionable cost", "allowed cost" and "disallowed cost." **§ 1630.5** details costs that are specifically unallowable under Corporation grants, without the prior written consent of the Corporation and details the maximum programs may spend without such approval

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45 CFR Part 1640: Application of Federal Law to LSC Recipients

§ 1640.3 states that as a condition of receiving LSC funds, a recipient must enter into a written contractual agreement with the Corporation that, with respect to its LSC funds, it will be subject to the Federal laws listed in **§1640.2(a)(1)**.

§1640.5 delineates the reporting requirements for the recipient should there be a violation of the agreement by recipient or any of its employees. These include notifying the Corporation within two working days of the date that the recipient or any of its employees has been charged with a violation of any of the Federal laws listed in 1640.2(a) with respect to its LSC funds. Telephonic notification is acceptable but must be followed by written notice within ten days.

45 CFR Part 1642: Attorneys Fees

Recipients or their employees cannot claim, or collect and retain attorney's fees available under any Federal or State law permitting or requiring the awarding of attorneys' fees, except in cases listed in §1642.4 of this part. **§§ 1642.5 and 1642.6** delineate the proper accounting for and use of attorneys' fees, and the acceptance of reimbursement from a client for out-of-pocket costs and incurred expenses in connection with a case, respectively.

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B. LSC REGULATIONS

Part 1610 USE OF NON-LSC FUNDS, TRANSFERS OF LSC FUNDS, PROGRAM INTEGRITY

Sec.

Authority: 42 U.S.C. 2996i; Pub. L. 104-208,110 Stat. 3009; Pub. L. 104-134, 110 Stat. 1321.

§1610.1 Purpose.

This part is designed to implement statutory restrictions on the use of non-LSC funds by LSC recipients and to ensure that no LSC-funded entity shall engage in any restricted activities and that recipients maintain objective integrity and independence from organizations that engage in restricted activities.

§1610.2 Definitions.

(a) *Purpose prohibited by the LSC Act* means any activity prohibited by the following sections of the LSC Act and those provisions of the Corporation's regulations that implement such sections of the Act:

(1) Sections 1006(d)(3), 1006(d)(4), 1007(a)(6), and 1007(b)(4) of the LSC Act and 45 CFR part 1608 of the LSC Regulations (Political activities);

(2) Section 1007(a)(10) of the LSC Act (Activities inconsistent with professional responsibilities);

(3) Section 1007(b)(1) of the LSC Act and 45 CFR part 1609 of the LSC regulations (Fee-generating cases);

(4) Section 1007(b)(2) of the LSC Act and 45 CFR part 1613 of the LSC Regulations (Criminal proceedings);

(5) Section 1007(b)(3) of the LSC Act and 45 CFR part 1615 of the LSC Regulations (Actions challenging criminal convictions);

(6) Section 1007(b)(7) of the LSC Act and 45 CFR part 1612 of the LSC Regulations (Organizing activities);

(7) Section 1007(b)(8) of the LSC Act (Abortions);

(8) Section 1007(b)(9) of the LSC Act (School desegregation); and

(9) Section 1007(b)(10) of the LSC Act (Violations of Military Selective Service Act or military desertion).

(b) *Activity prohibited by or inconsistent with Section 504* means any activity prohibited by, or inconsistent with the requirements of, the following sections of 110 Stat. 1321 (1996) and those provisions of the Corporation's regulations that implement those sections:

(1) Section 504(a)(1) and 45 CFR part 1632 of the LSC Regulations (Redistricting);

(2) Sections 504(a)(2) through (6), as modified by Sections 504(b) and (e), and 45 CFR part 1612 of the LSC Regulations (Legislative and administrative advocacy);

(3) Section 504(a)(7) and 45 CFR part 1617 of the LSC Regulations (Class actions);

(4) Section 504(a)(8) and 45 CFR part 1636 of the LSC Regulations (Client identification and statement of facts);

(5) Section 504(a)(9) and 45 CFR part 1620 of the LSC Regulations (Priorities);

(6) Section 504(a)(10) and 45 CFR part 1635 of the LSC Regulations (Timekeeping);

(7) Section 504(a)(11) and 45 CFR part 1626 of the LSC Regulations (Aliens);

(8) Section 504(a)(12) and 45 CFR part 1612 of the LSC Regulations (Public policy training);

(9) Section 504(a)(13) and 45 CFR part 1642 of the LSC Regulations (Attorneys' fees);

(10) Section 504(a)(14) (Abortion litigation);

(11) Section 504(a)(15) and 45 CFR part 1637 of the LSC Regulations (Prisoner litigation);

(12) Section 504(a) (16), as modified by Section 504(e), and 45 CFR part 1639 of the LSC Regulations (Welfare reform);

(13) Section 504(a)(17) and 45 CFR part 1633 of the LSC Regulations (Drug-related evictions); and

(14) Section 504(a)(18) and 45 CFR part 1638 of the LSC Regulations (In-person solicitation).

(c) *IOLTA funds* means funds derived from programs established by State court rules or legislation that collect and distribute interest on lawyers' trust accounts.

(d) *Non-LSC funds* means funds derived from a source other than the Corporation.

(e) *Private funds* means funds derived from an individual or entity other than a governmental source or LSC.

(f) *Public funds* means non-LSC funds derived from a Federal, State, or local government or instrumentality of a government. For purposes of this part, IOLTA funds shall be treated in the same manner as public funds.

(g) *Transfer* means a payment of LSC funds by a recipient to a person or entity for the purpose of conducting programmatic activities that are normally conducted by the recipient, such as the representation of eligible clients, or that provide direct support to the recipient's legal assistance activities. *Transfer* does not include any payment of LSC funds to vendors, accountants or other providers of goods and services made by the recipient in the normal course of business.

(h) *Tribal funds* means funds received from an Indian tribe or from a private nonprofit foundation or organization for the benefit of Indians or Indian tribes.

§1610.3 Prohibition.

A recipient may not use non-LSC funds for any purpose prohibited by the LSC Act or for any activity prohibited by or inconsistent with Section 504, unless such use is authorized by §§1610.4, 1610.6 or 1610.7 of this part.

§1610.4 Authorized use of non-LSC funds.

(a) A recipient may receive tribal funds and expend them in accordance with the specific purposes for which the tribal funds were provided.

(b) A recipient may receive public or IOLTA funds and use them in accordance with the specific purposes for which they were provided, if the funds are not used for any activity prohibited by or inconsistent with Section 504.

(c) A recipient may receive private funds and use them in accordance with the purposes for which they were provided, provided that the funds are not used for any activity prohibited by the LSC Act or prohibited or inconsistent with Section 504.

(d) A recipient may use non-LSC funds to provide legal assistance to an individual who is not financially eligible for services under part 1611 of this chapter, provided that the funds are used for the specific purposes for which those funds were provided and are not used for any activity prohibited by the LSC Act or prohibited by or inconsistent with Section 504.

§1610.5 Notification.

(a) Except as provided in paragraph (b) of this section, no recipient may accept funds from any source other than the Corporation, unless the recipient provides to the source of the funds written notification of the prohibitions and conditions which apply to the funds.

(b) A recipient is not required to provide such notification for receipt of contributions of less than $250.

§1610.6 Applicability.

Notwithstanding §1610.7(a), the prohibitions referred to in §§1610.2(a)(4) (Criminal proceedings), (a)(5) (Actions challenging criminal convictions), (b)(7) (Aliens) or (b)(11) (Prisoner litigation) of this part will not apply to:

(a) A recipient's or subrecipient's separately funded public defender program or project; or

(b) Criminal or related cases accepted by a recipient or subrecipient pursuant to a court appointment.

§1610.7 Transfers of LSC funds.

(a) If a recipient transfers LSC funds to another person or entity, the prohibitions and requirements referred to in this part, except as modified by paragraphs (b) and (c) of this section, will apply both to the LSC funds transferred and to the non-LSC funds of the person or entity to whom those funds are transferred.

(b)(1) In regard to the requirement in §1610.2(b)(5) on priorities, persons or entities receiving a transfer of LSC funds shall either:

(i) use the funds transferred consistent with the recipient's priorities; or

(ii) establish their own priorities for the use of the funds transferred consistent with 45 CFR part 1620;

(2) In regard to the requirement in §1610.2(b)(6) on timekeeping, persons or entities receiving a transfer of LSC funds are required to maintain records of time spent on each case or matter undertaken with the funds transferred.

(c) For a transfer of LSC funds to bar associations, *pro bono* programs, private attorneys or law firms, or other entities for the sole purpose of funding private attorney involvement activities (PAI) pursuant to 45 CFR part 1614, the prohibitions or requirements of this part shall apply only to the funds transferred.

§1610.8 Program integrity of recipient.

(a) A recipient must have objective integrity and independence from any organization that engages in restricted activities. A recipient will be found to have objective integrity and independence from such an organization if:

(1) The other organization is a legally separate entity;

(2) The other organization receives no transfer of LSC funds, and LSC funds do not subsidize restricted activities; and

(3) The recipient is physically and financially separate from the other organization. Mere bookkeeping separation of LSC funds from other funds is not sufficient. Whether sufficient physical and financial separation exists will be determined on a case-by-case basis and will be based on the totality of the facts. The presence or absence of any one or more factors will not be determinative. Factors relevant to this determination shall include but will not be limited to:

(i) the existence of separate personnel;

(ii) the existence of separate accounting and timekeeping records;

(iii) the degree of separation from facilities in which restricted activities occur, and the extent of such restricted activities; and

(iv) the extent to which signs and other forms of identification which distinguish the recipient from the organization are present.

(b) Each recipient's governing body must certify to the Corporation within 180 days of the effective date of this part that the recipient is in compliance with the requirements of this section. Thereafter, the recipient's governing body must certify such compliance to the Corporation on an annual basis.

§1610.9 Accounting.

Funds received by a recipient from a source other than the Corporation shall be accounted for as separate and distinct receipts and disbursements in a manner directed by the Corporation.

PART 1614 PRIVATE ATTORNEY INVOLVEMENT

Sec.

1614.3 Range of activities.

1614.4 Procedure.

1614.5 Prohibition of revolving litigation funds.

1614.6 Waivers.

1614.7 Failure to comply.

Authority: Sec. 1007(a)(2)(C) and sec. 1007(a)(3); (42 U.S.C. 2996f(a)(2)(C) and 42 U.S.C. 2996f(a)(3)).

Source: 50 FR 48591, Nov. 26, 1985, unless otherwise noted.

§ **1614.1 Purpose.**

(a) This part is designed to ensure that recipients of Legal Services Corporation funds involve private attorneys in the delivery of legal assistance to eligible clients. Except as provided hereafter, a recipient of Legal Services Corporation funding shall devote an amount equal to at least twelve and one-half percent (12½%) of the recipient's LSC annualized basic field award to the involvement of private attorneys in such delivery of legal services; this requirement is hereinafter sometimes referred to as the "PAI requirement". Funds received from the Corporation as one-time special grants shall not be considered in determining a recipient's PAI requirement.

(b) Recipients of Native American or migrant funding shall provide opportunity for involvement in the delivery of services by the private bar in a manner which is generally open to broad participation in those activities undertaken with those funds, or shall demonstrate to the satisfaction of the Corporation that such involvement is not feasible.

(c) Because the Corporation's PAI requirement is based upon an effort to generate the most possible legal services for eligible clients from available, but limited, resources, recipients should attempt to assure that the market value of PAI activities substantially exceeds the direct and indirect costs being allocated to meet the requirements of this Part.

(d) As of January 1, 1986, the term "private attorney" as used in this Part means an attorney who is not a staff attorney as defined in Section 1600.1 of these regulations.

(e) After the effective date of this regulation, no PAI funds shall be committed for direct payment to any attorney who for any portion of the previous two years has been a staff attorney as defined in Section 1600.1 of these regulations; provided, however, that, for the remainder of the 1986 fiscal year, recipients may honor contractual arrangements made to such private attorneys if these arrangements were made before the effective date of this regulation; provided, further, however, that this paragraph shall not be construed to restrict the use of PAI funds in a pro bono or judicare project on the same terms that are available to other attorneys; and provided further, however, that this paragraph shall not be construed to restrict the payment of PAI funds as a result of work performed by an attorney who practices in the same firm with such former staff attorney.

[50 FR 48591, Nov. 26, 1985, as amended at 51 FR 21559, June 13, 1986]

§ 1614.2 General policy.

(a) This part implements the policy adopted by the Board of Directors of the Corporation which requires that a substantial amount of funds be made available to encourage the involvement of private attorneys in the delivery of legal assistance to eligible clients through both pro bono and compensated mechanisms, and that such funds be expended in an economic and efficient manner.

(b) In the case of recipients whose service areas are adjacent, coterminous or overlapping, the recipients may enter into joint efforts to involve the private attorneys in the delivery of legal services to eligible clients, subject to the prior approval of the Office of Field Services. In order to be approved the joint venture plan must meet the following conditions:

(1) The recipients involved in the joint venture must plan to expend at least twelve and one-half percent (12½%) of the aggregate of their basic field awards on PAI. In the case of recipients with adjacent service areas, 12½% of each recipient's grant shall be expended to PAI; provided, however, that such expenditure is subject to waiver under Section 1614.6;

(2) Each recipient in the joint venture must be a bona fide participant in the activities undertaken by the joint venture; and

(3) The joint PAI venture must provide an opportunity for involving private attorneys throughout the entire joint service area(s).

(c) Private attorney involvement shall be an integral part of a total local program undertaken within the established priorities of that program in a manner that furthers the statutory requirement of high quality, economical and effective client-centered legal assistance to eligible clients. Decisions concerning implementation of the substantial involvement requirement rest with the recipient through its governing body, subject to review and evaluation by the Corporation.

§ 1614.3 Range of activities.

(a) Activities undertaken by the recipient to meet the requirements of this part must include the direct delivery of legal assistance to eligible clients through programs such as organized pro bono plans, reduced fee plans, judicare panels, private attorney contracts, or those modified pro bono plans which provide for the payment of nominal fees by eligible clients and/or organized referral systems; except that payment of attorney's fees through "revolving litigation fund" systems, as described in Section 1614.5 of this part, shall neither be used nor funded under this part nor funded with any LSC support;

(b) Activities undertaken by recipients to meet the requirements of this part may also include, but are not limited to:

(1) Support provided by private attorneys to the recipient in its delivery of legal assistance to eligible clients on either a reduced fee or pro bono basis through the provision of community legal education, training, technical assistance, research, advice and counsel; co-counseling arrangements; or the use of private law firm facilities, libraries, computer-assisted legal research systems or other resources; and

(2) Support provided by the recipient in furtherance of activities undertaken pursuant to this Section including the provision of training, technical assistance, research, advice and counsel, or the use of recipient facilities, libraries, computer assisted legal research systems or other resources.

(c) The specific methods to be undertaken by a recipient to involve private attorneys in the provision of legal assistance to eligible clients will be determined by the recipient's taking into account the following factors:

(1) The priorities established pursuant to Part 1620 of these regulations;

(2) The effective and economic delivery of legal assistance to eligible clients;

(3) The linguistic and cultural barriers to effective advocacy.

(4) The actual or potential conflicts of interest between specific participating attorneys and individual eligible clients; and

(5) The substantive and practical expertise, skills, and willingness to undertake new or unique areas of the law of participating attorneys.

(d) Systems designed to provide direct services to eligible clients by private attorneys on either a pro bono or reduced fee basis, shall include at a minimum, the following components:

(1) Intake and case acceptance procedures consistent with the recipient's established priorities in meeting the legal needs of eligible clients;

(2) Case assignments which ensure the referral of cases according to the nature of the legal problems involved and the skills, expertise, and substantive experience of the participating attorney;

(3) Case oversight and follow-up procedures to ensure the timely disposition of cases to achieve, if possible, the result desired by the client and the efficient and economical utilization of recipient resources; and

(4) Access by private attorneys to LSC recipient resources, including those of LSC national and state support centers, that provide back-up on substantive and procedural issues of the law.

(e) The recipient shall demonstrate compliance with this Part by utilizing financial systems and procedures and maintaining supporting documentation to identify and account separately for costs related to the PAI effort. Such systems and records shall meet the requirements of the Corporation's Audit and Accounting Guides for Recipients and Auditors and shall have the following characteristics:

(1) They shall accurately identify and account for:

(i) The recipient's administrative, overhead, staff, and support costs related to PAI activities. Non-personnel costs shall be allocated on the basis of reasonable operating data. All methods of allocating common costs shall be clearly documented. If any direct or indirect time of staff attorneys or paralegals is to be allocated as a cost to PAI, such costs must be documented by time sheets accounting for the time those employees have spent on PAI activities. The timekeeping requirement does not apply to such employees as receptionists, secretaries, intake personnel or bookkeepers; however, personnel cost allocations for non-attorney or non-paralegal staff should be based on other reasonable operating data which is clearly documented;

(ii) Payments to private attorneys for support or direct client services rendered. The recipient shall maintain contracts on file which set forth payment systems, hourly rates, and maximum allowable fees. Bills and/or invoices from private attorneys shall be submitted before payments are made. Encumbrances shall not be included in calculating whether a recipient has met the requirement of this part;

(iii) Contractual payments to individuals or organizations that undertake administrative, support, and/or direct services to eligible clients on behalf of the recipient consistent with the provisions of this part. Contracts concerning transfer of LSC funds for PAI activities shall require that such funds be accounted for by the recipient in accordance with LSC guidelines, including the requirements of the Audit and Accounting Guide for Recipients and Auditors and 45 CFR Part 1627;

(iv) Other such actual costs as may be incurred by the recipient in this regard.

(2) Support and expenses relating to the PAI effort must be reported separately in the recipient's year-end audit. This shall be done by establishing a separate fund or providing a separate schedule in the financial statement to account for the entire PAI allocation. Recipients are not required to establish separate bank accounts to segregate funds allocated to PAI. Auditors are required to perform sufficient audit tests to enable them to render an opinion on the recipient's compliance with the requirements of this part.

(3) In private attorney models, attorneys may be reimbursed for actual costs and expenses. Attorney's fees paid may not exceed 50% of the local prevailing market rate for that type of service.

(4) All records pertaining to a recipient's PAI requirements which do not contain client confidences or secrets as defined by applicable state law shall be made available for inspection and review by LSC auditors and monitors during regular business hours.

§ 1614.4 Procedure.

(a) The recipient shall develop a plan and budget to meet the requirements of this part which shall be incorporated as a part of the refunding application or initial grant application. The budget shall be modified as necessary to fulfill this part. That plan shall take into consideration:

(1) The legal needs of eligible clients in the geographical area served by the recipient and the relative importance of those needs consistent with the priorities established pursuant to section 1007(a)(2)(C) of the Legal Services Corporation Act (42 U.S.C. 2996f(a)(2)(C)) and Part 1620 of the Regulations (45 CFR Part 1620) adopted pursuant thereto;

(2) The delivery mechanisms potentially available to provide the opportunity for private attorneys to meet the established priority legal needs of eligible clients in an economical and effective manner; and

(3) The results of the consultation as required below.

(b) The recipient shall consult with significant segments of the client community, private attorneys, and bar associations, including minority and women's bar associations, in the recipient's service area in the development of its annual plan to provide for the involvement of private attorneys in the provision of legal assistance to eligible clients and shall document that each year its proposed annual plan has been presented to all local bar associations within the recipient's service area and shall summarize their response.

§ 1614.5 Prohibition of revolving litigation funds.

(a) A revolving litigation fund system is a system under which a recipient systematically encourages the acceptance of fee-generating cases as defined in Section 1609.2 of these regulations by advancing funds to private attorneys to enable them to pay costs, expenses, or attorneys fees for representing clients.

(b) No funds received from the Legal Services Corporation shall be used to establish or maintain revolving litigation fund systems.

(c) The prohibition in paragraph (b) of this section does not prevent recipients from reimbursing or paying private attorneys for costs and expenses, provided:

(1) The private attorney is representing an eligible client in a matter in which representation of the eligible client by the recipient would be allowed under the Act and under the Corporation's Regulations; and

(2) The private attorney has expended such funds in accordance with a schedule previously approved by the recipient's governing body or, prior to initiating action in the matter, has requested the recipient to advance the funds.

(d) Nothing in this section shall prevent a recipient from recovering from a private attorney the amount advanced for any costs, expenses, or fees from an award to the attorney for representing an eligible client.

§ 1614.6 Waivers.

(a) While it is the expectation and experience of the Corporation that most basic field programs can effectively expend their PAI requirement, there are some circumstances, temporary or permanent, under which the goal of economical and effective use of Corporation funds will be furthered by a partial, or in exceptional circumstances, a complete waiver of the PAI requirement.

(b) A complete waiver shall be granted by the Office of Field Services (OFS) when the recipient shows to the satisfaction of OFS that:

(1) Because of the unavailability of qualified private attorneys, an attempt to carry out a PAI program would be futile; or

(2) All qualified private attorneys in the program's service area either refuse to participate or have conflicts generated by their practice which render their participation inappropriate.

(c) A partial waiver shall be granted by OFS when the recipient shows to the satisfaction of OFS that:

(1) The population of qualified private attorneys available to participate in the program is too small to use the full PAI allocation economically and effectively; or

(2) Despite the recipient's best efforts too few qualified private attorneys are willing to participate in the program to use the full PAI allocation economically and effectively; or

(3) Despite a recipient's best efforts,-including, but not limited to , communicating its problems expending the required amount to OFS and requesting and availing itself of assistance and/or advice from OFS regarding the problem-expenditures already made during a program year are insufficient to meet the PAI requirement, and there is insufficient time to make economical and efficient expenditures during the remainder of a program year, but in this instance, unless the shortfall resulted from unforeseen and unusual circumstances, the recipient shall accompany the waiver request with a plan to avoid such a shortfall in the future; or

(4) The recipient uses a fee-for-service program whose current encumbrances and projected expenditures for the current fiscal year would meet the requirement, but its actual current expenditures do not meet the requirement, and could not be increased to do so economically and effectively in the remainder of the program year, or could not be increased to do so in a fiscally responsible manner in view of outstanding encumbrances; or

(5) The recipient uses a fee-for-service program and its PAI expenditures in the prior year exceeded the twelve and one-half percent (12½%) requirement but, because of variances in the timing of work performed by the private attorneys and the consequent billing for that work, its PAI expenditures for the current year fail to meet the twelve and one-half percent (12½%) requirement; or

(6) If, in the reasonable judgment of the recipient's governing body, it would not be economical and efficient for the recipient to expend its full 12½% of Corporation funds on PAI activities, provided that the recipient has handled and expects to continue to handle at least 12½% of cases brought on behalf of eligible clients through its PAI program(s).

(d) (1) A waiver of special accounting and bookkeeping requirements of this part may be granted by the Audit Division with the concurrence of OFS, if the recipient shows to the satisfaction of the Audit Division of OFS that such waiver will advance the purpose of this part as expressed in Sections 1614.1 and 1614.2.

(2) As provided in 45 CFR 1627.3(c) with respect to subgrants, alternatives to Corporation audit requirements or to the accounting requirements of this Part may be approved for subgrants by the Audit Division with the concurrence of OFS; such alternatives for PAI subgrants shall be approved liberally where necessary to foster increased PAI participation.

(e) Waivers of the PAI expenditure requirement may be full or partial, that is, the Corporation may waive all or some of the required expenditure for a fiscal year.

(1) Applications for waivers of any requirement under this Part may be for the current, or next fiscal year. All such applications must be in writing. Applications for waivers for the current fiscal year must be received by the Corporation during the current fiscal year.

(2) At the expiration of a waiver a recipient may seek a similar or identical waiver.

(f) All Waiver requests shall be addressed to the Office of Field Services (OFS) or the Audit Division as is appropriate under the preceding provisions of this Part. The Corporation shall make a written response to each such request postmarked not later than thirty (30) days after its receipt. If the request is denied, the Corporation will provide the recipient with an explanation and statement of the grounds for denial. If the waiver is to be denied because the information submitted is insufficient, the Corporation will inform the recipient as soon as possible, both orally and in writing, about what additional information is needed. Should the Corporation fail to so respond, the request shall be deemed to be granted.

§ 1614.7 Failure to comply.

(a) If a recipient fails to comply with the expenditure required by this part and if that recipient fails without good cause to seek a waiver during the term of the grant or contract, the Corporation shall withhold from the recipient's support payments an amount equal to the difference between the amount expended on PAI and twelve and one-half percent (12½%) of the recipient's basic field award.

(b) If a recipient fails with good cause to seek a waiver, or applies for but does not receive a waiver, or receives a waiver of part of the PAI requirement and does not expend the amount required to be expended, the PAI expenditure requirement for the ensuing year shall be increased for that recipient by an amount equal to the difference between the amount actually expended and the amount required to be expended.

(c) Any funds withheld by the Corporation pursuant to this section shall be made available by the Corporation for use in providing legal services in the recipient's service area through PAI programs. Disbursement of these funds shall be made through a competitive solicitation and awarded on the basis of efficiency, quality, creativity, and demonstrated commitment to PAI service delivery to low-income people.

(d) The withholding of funds under this section shall not be construed as a termination of financial assistance under Part 1606 of these regulations or a denial of refunding under Part 1625 of these regulations.

PART 1627 SUBGRANTS AND MEMBERSHIP FEES AND DUES

Sec.

Authority: Secs. 1006(b)(1), 1007(a)(3), and 1008(e) Legal Services Corporation Act of 1974, as amended (42 U.S.C. 2996e(b)(1), 2996f(a), and 2996g(e)).

Source: 48 FR 54209, Nov. 30, 1983, unless otherwise noted.

§ 1627.1 Purpose.

In order to promote accountability for Corporation funds and the observance of the provisions of the Legal Services Corporation Act and the Corporation's regulations adopted pursuant thereto, it is necessary to set out the rules under which Corporation funds may be transferred by recipients to other organizations (including other recipients).

§ 1627.2 Definitions.

(a) **"Recipient"** as used in this part means any recipient as defined in section 1002(6) of the Act and any grantee or contractor receiving funds from the Corporation under section 1006(a)(1)(B) or 1006(a)(3) of the Act.

(b)(1) **"Subrecipient"** shall mean any entity that accepts Corporation funds from a recipient under a grant contract, or agreement to conduct certain activities specified by or supported by the recipient related to the recipient's programmatic activities. Such activities would normally include those that might otherwise be expected to be conducted directly by the recipient itself, such as representation of eligible clients, or which provide direct support to a recipient's legal assistance activities or such activities as client involvement, training or state support activities. Such activities would not normally include those that are covered by a fee-for-service arrangement, such as those provided by a private law firm or attorney representing a recipient's clients on a contract or judicare basis, except that any such arrangement involving more than $25,000 shall be included. Subrecipient activities would normally also not include the provision of goods or services by vendors or consultants in the normal course of business if such goods or services would not be expected to be provided directly by the recipient itself, such as auditing or business machine purchase and/or maintenance. A single entity could be a subrecipient with respect to some activities it conducts for a recipient while not being a subrecipient with respect to other activities it conducts for a recipient.

(2) **"Subgrant"** shall mean any transfer of Corporation funds from a recipient which qualifies the organization receiving such funds as a subrecipient under the definition set forth in paragraph (b)(1) of this section.

(c) **"Membership fees or dues"** as used in this part means payments to an organization on behalf of a program or individual to be a member thereof, or to acquire voting or participatory rights therein.

§ 1627.3 Requirements for all subgrants.

(a)(1) All subgrants must be submitted in writing to the Corporation for prior, written approval. The submission shall include the terms and conditions of the subgrant and the amount of funds intended to be transferred.

(2) The Corporation shall have 45 days to approve, disapprove, or suggest modifications to the subgrant. A subgrant which is disapproved or to which modifications are suggested may be resubmitted for approval. Should the Corporation fail to take action within 45 days, the recipient shall notify the Corporation of this failure and, unless the Corporation responds within 7 days of the receipt of such notification, the subgrant shall be deemed to have been approved.

(3) Any subgrant not approved according to the procedures of paragraph (a)(2) of this section shall be subject to audit disallowance and recovery of all the funds expended pursuant thereto.

(4) Any subgrant which is a continuation of a previous subgrant and which expires before March 1, 1984 may be extended until March 1, 1984, if a new subgrant agreement is submitted for approval to the Corporation by January 15, 1984. In the event the Corporation refuses to allow the renewal of any such submitted agreement, the recipient shall be permitted to allow the subrecipient 60 days' funding to close out the subgrant activities.

(b)(1) A subgrant may not be for a period longer than one year, and all funds remaining at the end of the grant period shall be considered part of the recipient's fund balance.

(2) All subgrants shall contain a provision providing for their orderly termination in the event that the recipient's funding is terminated or the recipient is not refunded and for suspension of activities if the recipient's funding is suspended.

(3) A substantial change in the work program of a subgrant or an increase or decrease in funding of more than 10% shall require Corporation approval pursuant to the provisions of section 1627.3(a). Minor changes of work program or changes in funding of less than 10% shall not require prior Corporation approval, but the Corporation shall be informed in writing thereof.

(c) Recipients shall be responsible for ensuring that subrecipients comply with the financial and audit provisions of the Corporation. The recipient is responsible for ensuring the proper expenditure, accounting for, and audit of delegated funds. Any funds delegated by a recipient to a subrecipient shall be subject to the audit and financial requirements of the Audit and Accounting Guide for Recipients and Auditors. The delegated funds may be separately disclosed and accounted for, and reported upon in the audited financial statements of a recipient; or such funds may be included in a separate audit report of the subrecipient. The relationship between the recipient and subrecipient will determine the proper method of financial reporting in accordance with generally accepted accounting principles. A subgrant agreement may provide for alternative means of assuring the propriety of subrecipient expenditures, especially in instances where a large organization receives a small subgrant. If such an alternate means is approved by the Audit Division of the Corporation, the information provided thereby shall satisfy the recipient's annual audit requirement with regard to the subgrant funds.

(d) The recipient shall be responsible for repaying the Corporation for any disallowed expenditures by a subrecipient, irrespective of whether the recipient is able to recover such expenditures from the subrecipient.

(e) To assure subrecipient compliance with the Act, Congressional restrictions having the force of law, Corporation Regulations (45 CFR Chapter XVI), and Corporation Guidelines or Instructions, contracts between a recipient and a subrecipient shall provide for the same oversight rights for the Corporation with respect to subrecipients as apply to recipients.

[48 FR 54209, Nov. 30, 1983; 49 FR 1703, Jan. 13, 1984]

§1627.4 Membership fees or dues.

(a) LSC funds may not be used to pay membership fees or dues to any private or nonprofit organization, whether on behalf of a recipient or an individual.

(b) Paragraph (a) of this section does not apply to the payment of membership fees or dues mandated by a governmental organization to engage in a profession, or to the payment of membership fees or dues from non-LSC funds.

§ 1627.5 Contributions.

Any contributions or gifts of Corporation funds to another organization or to an individual are prohibited.

§ 1627.6 Transfers to other recipients.

(a) The requirements of Section 1627.3 shall apply to all subgrants by one recipient to another recipient.

(b) The subrecipient shall audit any funds subgranted to it in its annual audit and supply a copy of this audit to the recipient. The recipient shall either submit the relevant part of this audit with its next annual audit or, if an audit has been recently submitted, submit it as an addendum to that recently submitted audit.

(c) In addition to the provisions of Section 1627.3(d), the Corporation may hold the subrecipient directly responsible for any disallowed expenditures of subgrant funds. Thus, the Corporation may recover all of the disallowed costs from either recipient or subrecipient or may divide the recovery between the two; the Corporation's total recovery may not exceed the amount of expenditures disallowed.

(d) Funds received by a recipient from other recipients in the form of fees and dues shall be accounted for and included in the annual audit of the recipient receiving these funds as Corporation funds.

§1627.7 Tax sheltered annuities, retirement accounts and pensions.

No provision contained in this part shall be construed to affect any payment by a recipient on behalf of its employees for the purpose of contributing to or funding a tax sheltered annuity, retirement account, or pension fund.

§ 1627.8 Recipient policies, procedures and recordkeeping.

Each recipient shall adopt written policies and procedures to guide its staff in complying with this part and shall maintain records sufficient to document the recipient's compliance with this part.

PART 1628 RECIPIENT FUND BALANCES

Sec.

Authority: Secs. 1006(b)(1)(A), 1007(a)(3); 42 U.S.C. 2996e(b)(1)(A), 42 U.S.C. 2996f(a)(3).

Source: 49 FR 21332, May 21, 1984, unless otherwise noted.

§ 1628.1 Purpose.

(a) This part is designed to ensure the timely allocation of Legal Services Corporation (LSC) funds for the effective and economical provision of high quality legal assistance to eligible clients. To that end, recipients will be permitted to maintain and re-program from year to year fund balances of no more than 10% of their annualized LSC support.

(b) A waiver of this policy up to a maximum of 25% of the recipient's annualized grant amount may be obtained under certain conditions as described in Section 1628.3(d). Funds carried over in excess of 10% or above the level permitted by a specific waiver will be recovered as set forth in section 1628.3(a).

§ 1628.2 Definitions.

(a) LSC **"support"** for the reporting period shall be defined as the sum of: (1) The annualized LSC grant award(s);

(2) Any additional income derived from an LSC grant (interest, rents, etc.); and

(3) That proportion of any reimbursement or recovery of direct payment to attorneys, proceeds from the sale of assets, or other compensation or income attributable to any Corporation grant.

(b) The LSC **"fund balance amount"** shall be determined solely by reference to the recipient's annual audit. (The fund balance reported in the recipient's annual audit is subject to review and approval by the Corporation's Audit Division. Noncompliance with provisions of the Corporation's Audit and Accounting Guide for Recipients and Auditors may result in an increase or decrease in the fund balance as reported in the audit.)

(c) The **"fund balance percentage"** shall be determined by expressing the fund balance amount as a percentage of the recipient's LSC support for the reporting period.

(d) **"Recipient"** as used in this part, means any recipient as defined in section 1002(6) of the LSC Act and any grantee or contractor receiving funds from the Corporation under section 1006(a)(1) or 1006(a)(3) of the Act.

§ 1628.3 Policy.

(a) In the absence of a waiver from the Director, Office of Field Services, any fund balance amount in excess of 10% of LSC support shall be repaid to the Corporation in a lump sum or by pro rata deductions from the recipient's grant checks for a specific number of months. The Office of Field Services shall determine which of the specified methods of repayment is reasonable and appropriate in each case after consultation with the recipient.

(b) After the Corporation's receipt and review of the recipient's annual audit, the Corporation shall provide written notice to the recipient of the fund balance amount due and payable to the Corporation as well as the method for repayment 30 days prior to the effective date for repayment either to occur or to commence in accordance with Section 1628.3(a).

(c) In no way shall any such reduction and/or deduction in LSC support be construed to affect permanently the annualized funding level of the recipient, nor shall any such reduction and/or deduction in LSC support be considered to be a termination or denial of refunding under 45 CFR 1606 and 1625 respectively.

(d) A waiver of the 10% ceiling may be granted at the discretion of the Corporation in extraordinary circumstances; such a waiver may be granted by the Corporation to extend the ceiling for fund balance amounts established under this regulation to a maximum of 25% of LSC support. Further, in addition to the established 10% ceiling, the Corporation shall grant a waiver up to 25% of direct payment to attorneys in the last audit to recipients who operate compensated private bar programs or components to be utilized exclusively to fund a cash reserve or encumbrance system for direct payment to attorneys. Such recipients must submit a timely written request to the Office of Field Services to obtain this waiver. However, under no circumstances will a recipient be allowed to retain a fund balance in excess of 25% of support.

(e) All one-time or special purpose grants awarded by the Corporation shall have an effective date and termination date. Such grants are not subject to this fund balance policy. Revenue and expenses relating to such grants must be reflected separately in the audit report submitted to the Corporation. This may be done by establishing a separate fund or by providing a separate supplemental schedule of revenue and expenses related to such grants as a part of the audit report. No funds provided under a one-time or special purpose grant may be expended subsequent to the termination date of the grant without the prior written approval of the Corporation. All unexpended funds under such grants shall be returned to the Corporation.

§ 1628.4 Procedure.

(a) Any recipient whose audited fund balance exceeds the ceiling set forth in Section 1628.1 shall submit to the Director, Office of Field Services, within 120 days after the close of the recipient's fiscal year, a statement of the fund balance which occurred according to the annual audit required by section 1009(c)(1) of the Legal Services Corporation Act, as amended. The funds will be recovered as set forth in Section 1628.3, unless excluded by a specific waiver.

(b) The recipient may, within 120 days after the close of its fiscal year, apply to the Director, Office of Field Services for a waiver of the 10% ceiling. Such application must specify:

(1) The fund balance amount according to the recipient's annual audit;

(2) The reason such fund balance has been attained;

(3) The recipient's plan for the disposition or reserve of such fund balance amount within the current grant period;

(4) The amount of fund balance projected to be carried forward at the close of the recipient's then current fiscal year; and,

(5) The extraordinary circumstances justifying the retention of the fund balance which include windfall receipts for which a recipient cannot reasonably plan, such as proceeds from the sale of property, receipt of direct payment to attorneys, and collection of insurance proceeds.

(c) Excess fund balance amounts shall not be expended by the recipient prior to approval of the waiver application by the Corporation.

(d) The decision of the Corporation regarding the granting of a waiver (other than the automatically granted waiver for a cash reserve for compensated bar programs) shall be guided by the statutory mandate requiring the recipient to provide high quality legal services in an effective and economical manner. In addition, the Corporation shall give special consideration to the following factors in reviewing a waiver request submitted pursuant to this regulation:

(1) Emergencies, unusual occurrences, or other extraordinary circumstances giving rise to the existence of a fund balance in excess of 10%, and the special needs of clients;

(2) The need for a recipient which operates a compensated bar program or component to maintain a cash reserve; and

(3) The recipient's financial management record.

(e) Excess fund balance amounts approved for expenditure must be separately reported in the current fiscal year audit. This may be done by establishing a separate fund or by providing a separate supplemental schedule as part of the audit report.

[49 FR 23056, June 4, 1984]

§ 1628.5 Fund balance deficits.

(a) Sound financial management practices such as those established in LSC's "Fundamental Criteria of an Accounting and Financial Reporting System," should preclude deficit spending. Use of current year LSC grant funds to liquidate deficit balances in the LSC fund from a preceding period(s) requires the prior written approval of the Corporation.

(b) The recipient may, within 120 days of the close of its fiscal year, apply to the Corporation for approval of the costs associated with the liquidation of the deficit balances in the LSC fund.

(c) In the absence of approval by the Corporation, expenditures of current year LSC grant funds to liquidate a deficit from a prior year shall be identified as questioned costs.

(d) The recipient's request must specify the same information relative to the deficit LSC fund balance as that set forth in sections 1628.4(b) (1), (2), (3), and (4). Additionally, the recipient must develop and submit a plan approved by its governing body describing the measures which will be implemented to prevent a recurrence of a deficit balance in the LSC fund. The Corporation reserves the right to require changes in the submitted plan.

(e) The decision of the Corporation regarding acceptance of these deficit-related costs shall be guided by the statutory mandate requiring the recipient to provide high quality legal services performed in an effective and economical manner. Special consideration will be given for emergencies, unusual occurrences, or other extraordinary circumstances giving rise to this situation.

PART 1629 BONDING OF RECIPIENTS

Sec.

Authority: Secs. 1006(b)(1)(A) and 1007(a)(3), Pub. L. 93-355, as amended, Pub. L. 95-222 (42 U.S.C. 2996e(1)(A) and 2996f(3)).

Source: 49 FR 28717, July 16, 1984, unless otherwise noted.

§ 1629.1 General.

(a) If any program which receives Corporation funds is not a government, or an agency or instrumentality thereof, such program shall carry fidelity bond coverage at a minimum level of at least ten (10) percent of the program's annualized LSC funding level for the previous fiscal year, or of the initial grant or contract, if the program is a new grantee or contractor. No coverage carried pursuant to this part shall be at a level less than $50,000.

(b) A fidelity bond is a bond indemnifying such program against losses resulting from the fraud or lack of integrity, honesty or fidelity of one or more employees, officers, agents, directors or other persons holding a position of trust with the program.

§ 1629.2 Persons required to be bonded.

(a) Every director, officer, employee and agent of a program who handles funds or property of the program shall be bonded as provided in this part.

(b) Such bond shall provide protection to the program against loss by reason of acts of fraud or dishonesty on the part of such director, officer, employee or agent directly or through connivance with others.

§ 1629.3 Criteria for determining handling.

(a) The term "handles" shall be deemed to encompass any relationship of a director, officer, employee or agent with respect to funds or other property which can give rise to a risk of loss through fraud or dishonesty. This shall include relationships such as those which involve access to funds or other property or decision-making powers with respect to funds or property which can give rise to such risk of loss.

(b) Subject to the application of the basic standard of risk of loss to each situation, the criteria for determining whether there is "handling" so as to require bonding are:

(1) Physical contact with cash, checks or similar property;

(2) The power to secure physical possession of cash, checks or similar property such as through access to a safe deposit box or similar depository, access to cash or negotiable instruments and assets, power of custody or safe-keeping, or the power to borrow or withdraw funds from a bank or other account whether or not physical contact actually takes place;

(3) The power to transfer or cause to be transferred property such as mortgages, title to land and buildings, or securities, through actual or apparent authority, to oneself or to a third party, or to be negotiated for value.

(c) Persons who actually disburse funds or other property, such as officers authorized to sign checks or other negotiable instruments, or persons who make cash disbursements, shall be considered to be "handling" such funds or property.

(d) In connection with disbursements, any persons with the power to sign or endorse checks or similar instruments or otherwise render them transferable, whether individually or as cosigners with one or more persons, shall each be considered to be "handling" such funds or other property.

(e) To the extent a person's supervisory or decision-making responsibility involves factors in relationship to funds discussed in paragraphs (b) (1), (2), (3), or paragraphs (c) and (d) of this section, such persons shall be considered to be "handling" in the same manner as any person to whom the criteria of those subparagraphs apply.

§ 1629.4 Meaning of fraud or dishonesty.

The term "fraud or dishonesty" shall be deemed to encompass all those risks of loss that might arise through dishonest or fraudulent acts in the handling of funds as delineated in Section 1629.3. As such, the bond must provide recovery for loss occasioned by such acts even though no personal gain accrues to the person committing the act and the act is not subject to punishment as a crime or misdemeanor, provided that within the law of the state in which the act is committed, a court could afford recovery under a bond providing protection against fraud or dishonesty. As applied under state laws, the term "fraud or dishonesty" encompasses such matters as larceny, theft, embezzlement, forgery, misappropriation, wrongful abstraction, wrongful conversion, willful misapplication or any other fraudulent or dishonest acts.

§ 1629.5 Form of bonds.

Any form of bond which may be described as individual, schedule or blanket, or any combination of such forms of bonds, shall be acceptable to meet the requirements of this part. The basic types of bonds in general usage are:

(a) An individual bond which covers a named individual in a stated penalty;

(b) A name schedule bond which covers a number of named individuals in the respective amounts set opposite their names;

(c) A position schedule bond which covers all of the occupants of positions listed in the schedule in the respective amounts set opposite such positions;

(d) A blanket bond which covers all the insured's directors, officers, employees and agents with no schedule or list of those covered being necessary and with all new directors, officers, employees and agents bonded automatically, in a blanket penalty.

§ 1629.6 Effective date.

(a) Each program shall certify in its Application for Refunding, beginning with the application for FY 1985 funds, that it has obtained a bond or bonds which satisfy the requirements of this part.

(b) A copy of such bond or bonds shall be provided to the Corporation at its request.

PART 1630 COSTS STANDARDS AND PROCEDURES

Sec.

Authority: 42 U.S.C. 2996e, 2996f, 2996g, 2996h(c)(1), and 2996i(c).

Source: 51 FR 29081, Aug. 13, 1986, unless otherwise noted.

§ 1630.1 Purpose.

This part is intended to provide uniform standards for allowability of costs and to provide a comprehensive, fair, timely, and flexible process for the resolution of questioned costs incurred by recipients of the Corporation. The Corporation has considered the standardized policies developed over years of federal experience with assistance to nonprofit organizations, and has adopted, or adapted, many of these policies where appropriate for the funding of legal services for eligible clients.

§ 1630.2 Definitions.

(a) A **"questioned cost"** is a charge or proposed charge to a recipient's Corporation funds which could be determined to be ineligible.

(b) An **"allowed cost"** is a cost that, after investigation, the Corporation has determined to be eligible for payment from a recipient's Corporation funds.

(c) A **"disallowed cost"** is a cost which has been determined to be ineligible for payment from a recipient's Corporation funds and includes any income the recipient may have derived from activities supported by that cost, including proceeds from the sale of assets and interest.

(d) **"Recipient"** as used in this part means any grantee or contractor receiving funds from the Corporation under sections 1006(a)(1) or 1006(a)(3) of the Act.

§ 1630.3 Burden of proof.

(a) The recipient shall at all times have the burden of proof under this Part.

(b) If a recipient defends a questioned cost on the basis that the funds used were not subject to the restriction cited by the Corporation, the recipient has the burden of proving that the funds actually expended were not in fact subject to that restriction.

§ 1630.4 Standards governing allowability of costs under Corporation grants or contracts.

(a) General criteria. Expenditures by a recipient are allowable under the recipient's grant or contract only if the recipient can demonstrate that the cost was:

(1) Actually incurred during the effective term of the grant or contract (unless allowed by Part 1628) and the recipient was liable for payment;

(2) Reasonable and necessary for the provision of legal services for eligible clients or for the accomplishment of another function specified in the grant or contract application as approved by the Corporation;

(3) Allocable to such function(s);

(4) In compliance with the Act, applicable appropriation acts, Corporation rules, regulations, guidelines, and instructions, the Corporation Audit and Accounting Guide for Recipients and Auditors, and the terms and conditions of the grant or contract;

(5) Consistent with policies and procedures that apply uniformly to both Corporation-financed and other activities of the recipient;

(6) Accorded consistent treatment;

(7) Determined in accordance with generally accepted accounting principles;

(8) Not included as a cost or used to meet cost sharing or matching requirements of any other federally financed program, unless the agency whose funds are being matched determines in writing that Corporation funds may be used for federal matching purposes; and

(9) Adequately and contemporaneously documented and the Corporation was given access during normal business hours to the documentation as filed in the recipient's normal business records.

(b) Reasonable costs. A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. If a cost is disallowed solely on the ground that it is excessive, only the amount that is larger than reasonable shall be disallowed. The question of the reasonableness of specific costs must be scrutinized with particular care in connection with recipients, or separate divisions thereof, which receive the preponderance of their support from grants or contracts with the Corporation or federal agencies, rather than through the sale of goods and services in free markets. In determining the reasonableness of a given cost, consideration shall be given to:

(1) Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the recipient or the performance of the grant or contract;

(2) The restraints or requirements imposed by such factors as generally accepted sound business practices, arms-length bargaining, federal and state laws and regulations, and the terms and conditions of the grant or contract;

(3) Whether the individuals concerned acted with prudence under the circumstances, considering their responsibilities to the recipient, its clients and employees, the public at large, the Corporation, and the federal government; and

(4) Significant deviations from the established practices of the recipient which may unjustifiably increase the grant or contract costs.

(c) Allocable costs. (1) A cost is allocable to a particular cost objective, such as a grant, project, service, or other activity, in accordance with the relative benefits received. A cost is allocable to a Corporation grant or contract if it is treated consistently with other costs incurred for the same purpose in like circumstances and if it:

(i) Is incurred specifically for the grant or contract;

(ii) Benefits both the grant or contract and other work and can be distributed in reasonable proportion to the benefits received; or

(iii) Is necessary to the overall operation of the recipient, although a direct relationship to any particular cost objective cannot be shown.

(2) Any cost allocable to a particular grant or contract or other cost objective under these principles may not be shifted to other Corporation grants or contracts to overcome funding deficiencies, or to avoid restrictions imposed by law or by the terms or conditions of the grant or contract.

(d) Applicable credits. (1) A recipient must deduct all applicable credits, as defined in paragraph (d)(2) of this section, from the costs it charges to a grant or contract from the Corporation.

(2) The term "applicable credits" refers to those receipts or reductions of expenditures which operate to offset or reduce expense items that are allocable to grants or contracts as direct or indirect costs. Typical examples of such transactions are purchase discounts, rebates or allowances, recoveries or indemnities on losses, insurance refunds, and adjustments of overpayments or erroneous charges. To the extent that such credits accruing to or received by the recipient relate to allowable costs they shall be credited to the grant or contract either as a cost reduction or cash refund, as appropriate.

(e) Program income. Program income represents gross income earned by the recipient from Corporation-supported activities, and includes, but is not limited to, income from service fees (including attorneys' fees and costs), sales of commodities and property, and interest earned on grant or contract advances or other funds.

(f) Advance understandings. (1) Under any given grant or contract the reasonableness and allocability of certain items of costs may be difficult to determine. This is particularly true in connection with recipients that receive a preponderance of their support from the Corporation. In order to avoid subsequent disallowance or dispute based on unreasonableness or nonallocability, it is often desirable to seek a written agreement with the Office of Monitoring, Audit, and Compliance in advance of incurring special or unusual costs. The absence of an advance agreement on any element of cost will not, in itself, affect the reasonableness or allocability of that element. Acceptance of the annual budget as part of the renewal of funding does not constitute an "advance understanding" or "approval", unless the cost or expenditure is identified and specifications of the purpose, amount, and all other information necessary to evaluate the necessity and reasonableness of the cost are included and explicit approval of the specific transaction is included with approval of the grant application. (2) Because there is significant potential for disagreement regarding the reasonableness, necessity, or allowability of costs allocable to the following activities, recipients are encouraged to seek advance understandings regarding-

(i) Conduct of or attendance at meetings (attended primarily by employees of other LSC recipients or a purpose of which is to encourage political activity), conferences, symposia, or training projects by participants, trainees, trainers, or employees;

(ii) Maintenance or occupancy of a branch office if a primary use of that office is to support legislative advocacy, formal rulemaking, or lobbying.

(g) Guidance. The Circulars of the Office of Management and Budget shall provide guidance for all allowable cost questions arising under this part when relevant policies or criteria therein are not inconsistent with the provisions of the Act, applicable appropriations acts, this part, the Audit and Accounting Guide for Recipients and Auditors, and Corporation rules, regulations, guidelines, and instructions.

§ 1630.5 Costs specifically unallowable under Corporation grants and contracts.

(a) No cost allocable to an activity that violates the Act, other provisions of law, Corporation rules, regulations, guidelines, instructions, or the terms of a recipient's grant or contract agreement may be charged to Corporation funds.

(b) Without prior approval of the Corporation (which approval shall not be withheld unless the Corporation determines that the cost would be inconsistent with the standards and policies of this part and which shall be valid for no more than one year), no cost allocable to any of the following may be charged to Corporation funds:

(1) The cost of a lease or purchase of equipment, furniture, books or similar personal property if the single item or combined purchase price is in excess of $10,000. In the case of a lease, the purchase price is determined by the prevailing market rate for purchase of the property leased, not by the lease price. "Combined purchase price" means the total cost of all the components of a system, such as a computer or telephone system, in which the components are planned as integral parts of the system or lease process. The addition of books to an existing library purchased during a prior audit year, of new printers to an existing computer system purchased during a prior audit year, or of new furniture to office furniture purchased during a prior audit year would not require prior approval unless the additions had a combined purchase price in excess of $10,000. When purchases or leases are made for more than one office, the "combined purchase price" includes the cost of all new system components for all offices affected;

(2) Purchases of real property;

(3) Consultant contracts in excess of $5,000 or consultant fees in excess of $261 per eight-hour day or $35 per hour except that

(i) The retention of expert witnesses or other consultants or attorneys secured on behalf of eligible clients shall not be considered consultant services, and

(ii) Audit services shall not be considered as consultant services, but other services that may be provided by a recipient's auditor, such as the preparation of interim financial reports or tax reports, shall be considered consultant services and shall require approval if the fees exceed the limits established by this subparagraph.

§ 1630.6 Effect of absence of prior approval.

The Corporation may not assert the absence of its approval as a basis for disallowance of a cost if it has not provided written notice to a recipient that it objects to a proposed cost expenditure involving Corporation funds, or to a proposed action that could result in a cost expenditure that the recipient will charge to Corporation funds, within sixty (60) days of receipt by the Office of Monitoring, Audit, and Compliance of a request for such approval, or within thirty (30) days of the receipt by that Office of all requested information about the proposal. The Corporation must make written request for additional information within forty-five (45) days of the receipt by the Office of Monitoring, Audit, and Compliance of the request for approval. This section does not apply to requests for approval made prior to the effective date of this regulation. If the request for prior approval is denied, the Corporation will provide the recipient with an explanation and statement of the grounds for denial.

§ 1630.7 Review and appeal process.

(a) When it questions a cost incurred by a recipient, the Corporation shall give written notice to the recipient and the Chairperson of its governing body stating the dollar amount of the cost and the factual and legal basis for questioning it. Such notice must be provided no more than six (6) years after the recipient incurred the cost or expended the funds.

(b) The recipient may respond with written evidence and argument to show that the cost was allowable, that the Corporation, for equitable, practical, or other reasons, should not recover all, or part of the amount, or that the recovery should be made in installments. If the recipient fails to respond within thirty (30) days of its receipt of notice, the cost shall be disallowed.

(c) Within forty-five (45) days of receiving the recipient's written response to the notice of questioned cost, the Corporation shall issue a determination that the cost has been allowed or disallowed and advise the recipient of the method and schedule for collection of any disallowed costs.

(d) Within thirty (30) days after it receives a determination from the Corporation that a questioned cost has been disallowed, a recipient may send a written request for review to the President of the Corporation, stating its reasons in detail.

(e) Within thirty (30) days after receipt of the written request for review, the President shall either adopt, modify, or reverse the determination. The decision shall be based on the written record, consisting of the notice, the recipient's response, the Corporation's determination, the recipient's request for review, and any response and analysis sent to the President by Corporate staff. The decision of the President, or his or her designee, shall become final upon receipt by the recipient of written notice of the decision. The Corporation shall send a copy of the staff's response and analysis to the recipient at the time it sends the President's decision.

(f) If the President has had prior involvement in the consideration of the issue, another executive employee who has had no prior involvement shall be designated to hear and decide the request for review.

§ 1630.8 Recovery of disallowed costs.

After completion of all action under Section 1630.7, the Corporation shall recover, in the form of a reduction in future grant checks or direct payment or otherwise, an amount not to exceed the total disallowed cost and any additional income derived from activities supported or assets purchased by means of the disallowed cost.

§ 1630.9 Other remedies; effect on other parts.

(a) In all cases in which a cost has been disallowed by the Corporation, the Corporation shall require that the recipient take the action needed to prevent recurrence of the activity that gave rise to such disallowed cost. In cases of serious financial mismanagement, fraud, or defalcation of funds, the Corporation may take appropriate action pursuant to Parts 1606, 1623, and 1625 of its regulations and shall make such referrals and recommendations as the circumstances warrant.

(b) Recovery of questioned costs by any means under this part is not to be construed to affect permanently the annualized funding level of the recipient, or to constitute a termination of financial assistance under Part 1606, a suspension of funding under Part 1623, or a denial of refunding under Part 1625.

§ 1630.10 Responsibility of subgrantees and subcontractors.

When disallowed costs arise from expenditures incurred under a subgrant or subcontract of Corporation funds, the recipient and the subrecipient or subcontractor will be held jointly and severally responsible for the actions of the subrecipient or subcontractor, as provided in 45 CFR Part 1627, and will be subject to all remedies available under this Part.

§ 1630.11 Time.

(a) Computation. Time limits specified in this Part shall be computed in accordance with Rules 6(a) and 6(e) of the Federal Rules of Civil Procedure.

(b) Enlargement. The President of the Corporation may, on written request for good cause shown, grant an enlargement of time and shall so notify the recipient in writing.

§ 1630.12 Non-public funds.

(a) No cost allocable to an activity that violates section 1010(c) of the Act or Part 1610 of these regulations may be charged to non-public funds.

(b) The Corporation shall, pursuant to this part, collect from the recipient's Corporation funds an amount not to exceed the amount of non-public funds allocated to such violation and any additional income derived therefrom.

PART 1631 EXPENDITURE OF GRANT FUNDS

Sec.

1631.1 Policy.

1631.2 Application and waiver.

Authority: 42 U.S.C. 2996e(b)(1)(A), 2996f(a)(3); Pub. L. 99-190, 99 Stat. 1185; Pub. L. 99-180, 99 Stat. 1136.

Source: 51 FR 24827, July 9, 1986, unless otherwise noted.

§ 1631.1 Policy.

No Legal Services Corporation funds, including income derived therefrom and those LSC funds held by organizations which control, are controlled by, or are subject to common control with, a recipient or subrecipient, a group of recipients and/or subrecipients, or agents or employees of such organizations shall be expended, unless such funds are expended in accordance with all of the restrictions and provisions of Pub. L. 99-180 of December 13, 1985, except that such funds may be expended for the continued representation of aliens prohibited by said Public Law where such representation commenced prior to January 1, 1983, or as approved by the Corporation.

§ 1631.2 Application and waiver.

(a) The Corporation may grant a waiver of the restrictions contained in this part to enable a program to complete representation in cases which commenced prior to January 1, 1986.

(b) Programs seeking a waiver pursuant to paragraph (a) of this section must submit documentation to the Corporation detailing their efforts to dispose of such cases in accordance with the procedures required in Section 1626.6(a)(1), (2) and (3), and receive Corporation approval to expend funds for completion of the affected cases.

PART 1635 TIMEKEEPING REQUIREMENT

Sec.

1635.1 Purpose.

1635.2 Definitions.

1635.3 Timekeeping Requirement.

1635.4 Administrative Provisions.

Authority: 42 U.S.C. §§ 2996e(b)(1)(A), 2996g(a), 2996g(b), 2996g(e).

Source: 61 FR 14261, April 1, 1996

§ 1635.1 Purpose.

This Part is intended to improve accountability for the use of all funds of a recipient by:

(a) Assuring that allocations of expenditures of Corporation funds pursuant to 45 CFR part 1630 are supported by accurate and contemporaneous records of the cases, matters, and supporting activities for which the funds have been expended;

(b) Enhancing the ability of the recipient to determine the cost of specific functions; and

(c) Increasing the information available to the Corporation for assuring recipient compliance with Federal law and Corporation rules and regulations.

§ 1635.2 Definitions.

As used in this part -

(a) A "**case**" is a form of program service in which an attorney or paralegal of a recipient provides legal services to one or more specific clients, including, without limitation, providing representation in litigation, administrative proceedings, and negotiations, and such actions as advice, providing brief services and transactional assistance, and assistance with individual PAI cases.

(b) A "**matter**" is an action which contributes to the overall delivery of program services but does not involve direct legal advice to or legal representation of one or more specific clients. Examples of matters include both direct services, such as community education presentations, operating pro se clinics, providing information about the availability of legal assistance, and developing written materials explaining legal rights and responsibilities; and indirect services, such as training, continuing legal education, general supervision of program services, preparing and disseminating desk manuals, PAI recruitment, intake when no case is undertaken, and tracking substantive law developments.

(c) A "**supporting activity**" is any action that is not a case or matter, including management and general, and fundraising.

§ 1635.3 Timekeeping Requirement.

(a) All expenditures of funds for recipient actions are, by definition, for cases, matters, or supporting activities. The allocation of all expenditures must be carried out in accordance with 45 CFR part 1630.

(b) Time spent by attorneys and paralegals must be documented by time records which record the amount of time spent on each case, matter, or supporting activity.

(1) Time records must be created contemporaneously and account for time in increments not greater than one-quarter of an hour which comprise all of the efforts of the attorneys and paralegals for which compensation is paid.

(2) Each record of time spent must contain: for a case, a unique client name or case number; for matters or supporting activities, an identification of the category of action on which the time was spent.

(c) The timekeeping system must be implemented within 30 days of the effective date of this regulation or within 30 days of the effective date of a grant or contract, whichever is later.

(d) The timekeeping system must be able to aggregate time record information from the time of implementation on both closed and pending cases by legal problem type.

§ 1635.4 Administrative Provisions.

Time records required by this section shall be available for examination by auditors and representatives of the Corporation, and by any other person or entity statutorily entitled to access to such records. The Corporation shall not disclose any time record except to a Federal, State or local law enforcement official or to an official of an appropriate bar association for the purpose of enabling such bar association official to conduct an investigation of an alleged violation of the rules of professional conduct.

Part 1640 APPLICATION OF FEDERAL LAW TO LSC RECIPIENTS

Sec.

Authority: Section 504(a)(19), Pub. L. 104-208, 110 Stat. 3009; Pub. L. 104-134, 110 Stat. 1321.

§1640.1 Purpose.

The purpose of this part is to ensure that recipients use their LSC funds in accordance with Federal law related to the proper use of Federal funds. This part also identifies the Federal laws which apply, and it provides notice of the consequences to a recipient of a violation of such Federal laws by a recipient, its employees or board members.

§1640.2 Definitions.

(a)(1) *Federal law relating to the proper use of Federal funds* means:

(i) 18 U.S.C. 201(Bribery of Public Officials and Witnesses);

(ii) 18 U.S.C. 286 (Conspiracy to Defraud the Government With Respect to Claims);

(iii) 18 U.S.C. 287(False, Fictitious or Fraudulent Claims);

(iv) 18 U.S.C. 371 (Conspiracy to Commit Offense or Defraud the United States);

(v) 18 U.S.C. 641(Public Money, Property or Records);

(vi) 18 U.S.C. 1001(Statements or Entries Generally);

(vii) 18 U.S.C. 1002 (Possession of False Papers to Defraud the United States);

(viii) 18 U.S.C. 1516 (Obstruction of Federal Audit);

(ix) 31 U.S.C. 3729 (False Claims);

(x) 31 U.S.C. 3730 (Civil Actions for False Claims), except that actions that are authorized by 31 U.S.C. 3730(b) to be brought by persons may not be brought against the Corporation, any recipient, subrecipient, grantee, or contractor of the Corporation, or any employee thereof;

(xi) 31 U.S.C. 3731 (False Claims Procedure);

(xii) 31 U.S.C. 3732 (False Claims Jurisdiction); and

(xiii) 31 U.S.C. 3733 (Civil Investigative Demands).

(2) For the purposes of the laws listed in paragraph (a)(1) of this section, LSC shall be considered a Federal agency and a recipient's LSC funds shall be considered to be Federal funds provided by grant or contract.

(b) A *violation of the agreement* means:

(1) That the recipient has been convicted of, or judgment has been entered against the recipient for, a violation of any of the laws listed in paragraph (a)(1) of this section, with respect to its LSC grant or contract, by the court having jurisdiction of the matter, and any appeals of the conviction or judgment have been exhausted or the time for the appeal has expired; or

(2) An employee or board member of the recipient has been convicted of, or judgment has been entered against the employee or board member for, a violation of any of the laws listed in paragraph (a)(1) of this section with respect to a recipient's grant or contract with LSC by the court having jurisdiction of the matter, and any appeals of the conviction or judgment have been exhausted or the time for appeal has expired, and the Corporation finds that the recipient has knowingly or through gross negligence allowed the employee or board member to engage in such activities.

§1640.3 Contractual agreement.

As a condition of receiving LSC funds, a recipient must enter into a written contractual agreement with the Corporation that, with respect to its LSC funds, it will be subject to the Federal laws listed in §1640.2(a)(1). The agreement shall include a statement that all of the recipient's employees and board members have been informed of such Federal law and of the consequences of a violation of such law, both to the recipient and to themselves as individuals.

§1640.4 Violation of agreement.

(a) A violation of the agreement under §1640.2(b)(1) shall result in the recipient's LSC grant or contract being terminated by the Corporation without need for a termination hearing. During the pendency of any appeal of a conviction or judgment, the Corporation may take such steps as it determines necessary to safeguard its funds.

(b) A violation of the agreement under §1640.2(b)(2) shall result in the recipient's LSC grant or contract being terminated by the Corporation. Prior to such termination, the Corporation shall provide notice and an opportunity to be heard for the sole purpose of determining whether the recipient knowingly or through gross negligence allowed the employee or board member to engage in the activities which led to the conviction or judgment. During the pendency of any appeal of a conviction or judgment or during the pendency of a hearing, the Corporation may take such steps as it determines necessary to safeguard its funds.

PART 1642 ATTORNEYS' FEES

Sec.

Authority: 42 U.S.C. 2996e(d)(6); Pub. L. 104-208, 110 Stat. 3009; Pub. L. 104-134, 110 Stat 1321, Section 504(a)(13).

§1642.1 Purpose.

This part is designed to insure that recipients or employees of recipients do not claim, or collect and retain attorneys' fees available under any Federal or State law permitting or requiring the awarding of attorneys' fees.

§1642.2 Definitions.

(a) *Attorneys' fees* means an award to compensate an attorney of the prevailing party made pursuant to common law or Federal or State law permitting or requiring the awarding of such fees or a payment to an attorney from a client's retroactive statutory benefits

(b) *Attorneys' fees* do not include the following:

(1) Payments made to a recipient or an employee of a recipient for a case in which a court appoints the recipient employee to provide representation pursuant to a statute or court rule or practice equally applicable to all attorneys in the jurisdiction, and in which the recipient or employee receives compensation under the same terms and conditions as are applied generally to attorneys practicing in the court in which the appointment is made;

(2) Payments made to a recipient or an employee of a recipient pursuant to a grant, contract or other agreement by a governmental agency or other third party for representation of clients;

(3) Payments received as a result of sanctions imposed by a court for violations of court rules or practices, or statutes relating to court practice, including Rule 11 or discovery rules of the Federal Rules of Civil Procedure, or similar State court rules or practices, or statutes; and

(4) Reimbursement of costs and expenses from an opposing party or from a client pursuant to §1642.6.

(c) An *award* is an order by a court or an administrative agency that the unsuccessful party pay the attorneys' fees of the prevailing party or an order by a court or administrative agency approving a settlement agreement of the parties which provides for payment of attorneys' fees by an adversarial party.

(d) To *claim* attorneys' fees means to include a request for attorneys' fees in any pleading.

§1642.3 Prohibition.

Except as permitted by §1642.4, no recipient or employee of a recipient may claim, or collect and retain attorneys' fees in any case undertaken on behalf of a client of the recipient.

§1642.4 Applicability of restriction on attorneys' fees.

(a) The prohibition contained in §1642.3 shall not apply to cases filed prior to April 26, 1996, except that the prohibition shall apply to any additional related claim for the client made in such a case on or subsequent to April 26, 1996.

(b) Except as permitted in paragraph (a) of this section, the prohibition contained in §1642.3 shall apply to any case undertaken by a private attorney on behalf of an eligible client when the attorney receives compensation from a recipient to provide legal assistance to such client under the recipient's private attorney involvement (PAI) program, judicare program, contract or other financial arrangement.

§1642.5 Accounting for and use of attorneys' fees.

(a) Attorneys' fees received by a recipient pursuant to §1642.4(a) for representation supported in whole or in part with funds provided by the Corporation shall be allocated to the fund in which the recipient's LSC grant is recorded in the same proportion that the amount of Corporation funds expended bears to the total amount expended by the recipient to support the representation.

(b) Attorneys' fees received pursuant to §1642.4(a) shall be recorded during the accounting period in which the money from the fee award is actually received by the recipient and may be expended for any purpose permitted by the LSC Act, regulations and other law applicable at the time the money is received.

§1642.6 Acceptance of reimbursement from a client.

(a) When a case results in a recovery of damages or statutory benefits, a recipient may accept reimbursement from the client for out-of-pocket costs and expenses incurred in connection with the case, if the client has agreed in writing to reimburse the recipient for such costs and expenses out of any such recovery.

(b) A recipient may require a client to pay court costs when the client does not qualify to proceed *in forma pauperis* under the rules of the jurisdiction.

§1642.7 Recipient policies, procedures and recordkeeping.

The recipient shall adopt written policies and procedures to guide its staff in complying with this part and shall maintain records sufficient to document the recipient's compliance with this part

APPENDIX X GLOSSARY OF TERMS

The following terms, some of which as defined by GAAP, are used throughout this Guide and are defined as follows:

Contribution	An unconditional transfer of cash or other assets to an entity or a settlement or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner.
Designated funds	Unrestricted funds set aside for specific purposes by actions of the governing body.
Donor-imposed Restriction	A donor stipulation that specifies a use for a contributed asset that is more specific than broad limits resulting from the nature of the organization, the environment in which it operates, and the purposes specified in its article of incorporation or bylaws or comparable documents for an unincorporated association. A restriction on an organization's use of the assets contributed may be temporary or permanent.
Encumbrances	Commitments in the form of orders, contracts, and similar items that will become payable when goods are delivered or services are rendered.
Endowment Fund	An established fund of cash, securities, or other assets to provide income for the maintenance of a not-for profit organization. The use of the assets of the fund may be permanently restricted, temporarily restricted, or unrestricted. Endowment funds are generally established by donor-restricted gifts and bequests to provide a permanent source of income, or a term endowment, which is to provide income for a specified period. The principal of a permanent endowment must be maintained permanently--not used up, expended, or otherwise exhausted--and is classified as permanently restricted net assets. The principal of a term endowment must be maintained for a specified term and is classified as temporarily restricted net assets. An organization's governing board may earmark a portion of its unrestricted net assets as a board-designated endowment (sometimes called funds functioning as endowment or quasi-endowment funds) to be invested to provide income for a long but unspecified period. The principal of board-designated endowment, which results from an internal designation, is not donor restricted and is classified as unrestricted net assets.
Expendable funds	Funds that are available to finance an organization's program and supporting services, including both unrestricted and restricted amounts.
Financial Oversight Committee	A group of board members appointed to provide assistance to the board of directors in fulfilling its fiduciary responsibilities relating to accounting and reporting practices, and to maintain a direct line of communication between the board and the independent accountant.
Functional Classification	A method of grouping expenses according to the purpose for which costs are incurred. The primary functional classifications are program services and two types of supporting activities: management and general, and fundraising.
Fund	An accounting entity established for the purpose of accounting for resources used for specific activities or objectives in accordance with special regulations, restrictions, or limitations.
Natural expense classification	A method of classifying expenditures according to their natural classification, such as salaries and wages, employee benefits, supplies, purchased services, and so forth.

Net Assets	The excess of assets over liabilities.
Nonreciprocal transfer	A transaction in which an entity incurs a liability or transfers an assets to another entity (or receives an asset or cancellation of a liability) without directly receiving (or giving) value in exchange.
Not-for-Profit Organization	An entity that possesses the following characteristics that distinguish it from a business enterprise: (a) contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return, (b) operating purposes other than to provide goods or services at a profit, and (c) absence of ownership interest like those of business enterprises. Not-for-profit organizations have those characteristics in varying degrees.
Permanent Restriction	A donor-imposed restriction that stipulates that resources be maintained permanently but permits the organization to use up or expend part or all of the income (or other economic benefits) derived from the donated assets.
Permanently Restricted Net Assets	The part of the net assets of a not-for-profit organization resulting (a) from contributions and other inflows of assets whose use by the organization is limited by donor-imposed stipulations that neither expire by passage of time nor can be fulfilled or otherwise removed by actions of the organization, (b) from other assets enhancements and diminishments subject to the same kinds of stipulations, and (c) from classification from (or to) other classes of net assets as a consequence of donor-imposed stipulations.
Reclassifications	Transfers of amounts from one net asset class to another, usually as a result of the release or lapsing of restrictions.
Restricted funds	Funds whose use is restricted by outside agencies or person as contrasted with funds over which the organization has complete control and discretion.
Restricted Support	Donor-restricted revenues or gains from contributions that increase either temporarily restricted net assets or permanently restricted net assets.
Revenues	Gross increases in assets, gross decreases in liabilities, or a combination of both from delivering or producing goods, rendering services, or other earning activities of an organization during a period, for example, dues, sale of services, ticket sales, fees, interest, dividends, and rent.
Segregation of Duties	An internal control procedure which prohibits an individual from being placed in a position of being able to both commit and conceal an irregularity.
Stipulation	A statement by a donor that creates a condition or restriction on the use of transferred resources.
Support	The conveyance of property from one person or organization to another without consideration, for example, donations, gifts, grants, or bequests.

Temporarily Restricted Net Assets	The part of the net assets of a not-for-profit organization resulting (a) from contributions and other inflows of assets whose use by the organization is limited by donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions of the organization pursuant to those stipulations, (b) from other assets enhancements and diminishments subject to the same kinds of stipulations, and (c) from classification to (or from) other classes of net assets as a consequence of donor-imposed stipulations, their expiration by passage of time, or their fulfillment and removal by actions of the organization pursuant to those stipulations.
Temporary Restriction	A donor-imposed restriction that permits the donee organization to use up or expend the donated assets as specified and is satisfied either by the passage of time or by actions of organization.
Unrestricted funds	Funds that have no external restriction on their use or purpose, that is, funds that can be used for any purpose designated by the governing board as distinguished from funds restricted externally for specific purposes (for example, for operations, plant, and endowments).
Unrestricted Net Assets	The part of net assets of a not-for-profit organization that is neither permanently restricted nor temporarily restricted by donor-imposed stipulations.
Voluntary Health and Welfare Organizations	Organizations formed for the purpose of performing voluntary services for various segments of society. They are tax exempt (organized for the benefit of the public), supported by the public, and operated on a "not-for-profit" basis. Most voluntary health and welfare organizations concentrate their efforts and expend their resources in an attempt to solve health and welfare problems of our society and, in many cases, those of specific individuals. As a group, voluntary health and welfare organizations include those not-for-profit organizations that derive their revenue primarily from voluntary contributions from the general public to be used for general or specific purposes connected with health, welfare, or community services. (Receipt of an LSC grant is not a basis for determining that an organization is a voluntary health and welfare organization for financial statement reporting purposes.)

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