

LEGAL SERVICES CORPORATION**45 CFR Part 1628****Recipient Fund Balances**

AGENCY: Legal Services Corporation.

ACTION: Proposed rule.

SUMMARY: This proposed rule would revise the Corporation's rule on recipient fund balances to provide the Corporation with more discretion to determine whether to permit a recipient to maintain a fund balance up to 25% of its LSC support for a particular reporting period. It also adds additional requirements and limitations applicable to waiver requests and the use of fund balances. Finally, the rule is restructured for clarity and for consistency with other LSC regulations.

DATES: Comments should be received on or before December 21, 1998.

ADDRESSES: Comments should be submitted to the Office of the General Counsel, Legal Services Corporation, 750 First St. NE., 11th Floor, Washington, DC 20002-4250.

FOR FURTHER INFORMATION CONTACT: Suzanne Glasow, Office of the General Counsel, 202-336-8817.

SUPPLEMENTARY INFORMATION: The Operations and Regulations Committee (Committee) of the Legal Services Corporation's (LSC) Board of Directors (Board) met on September 11, 1998, in Chicago, Illinois, to consider proposed revisions to the Corporation's rule governing recipient fund balances, 45 CFR Part 1628. The Committee adopted this proposed rule for publication in the *Federal Register* for public comment.

There is no statutory provision that limits the amount of a fund balance an LSC recipient may carry over from one year to another. In 1980, the General Accounting Office (GAO) released a report finding that, because LSC grantees were not required to return funds not expended by the end of the year, some grantees had relatively large carryovers when compared to their total grants. The GAO report recommended that the Corporation "should closely monitor the expenditure of funds by grantees to minimize year end fund carryovers and adjust subsequent year funding of grantees with excess fund balances." In response to the report, the Corporation took various actions to regulate recipient fund balances that culminated in the promulgation of the current rule. See LSC memoranda (December 18, 1980 & March 18, 1982), grant conditions, Instructions (Instruction 83-4, 48 FR 560), and 45 CFR Part 1628 (49 FR 21331, effective

on June 20, 1984, and corrected at 49 FR 23056, June 4, 1984).

Generally, this proposed rule is intended to provide the Corporation with more discretion to determine whether to permit a recipient to maintain a fund balance up to 25% of its LSC support for a particular reporting period and sets forth the requirements and limitations applicable to waiver requests and the use of fund balances. Finally, the rule is restructured for clarity and consistency with other LSC regulations. A section-by-section analysis is provided below.

Section 1628.1 Purpose

This section is substantively revised. Provisions have been deleted or moved to other parts of the rule because they do not constitute statements of the purpose or function of the rule. The purpose of this rule is to delineate the Corporation's policies and procedures applicable to recipient fund balances. In addition, the rule's policies and requirements are intended to ensure the timely expenditure of LSC funds for the effective and economical provision of high quality legal assistance to eligible clients.

Section 1628.2 Definitions

The proposed revisions to this section are intended to clarify or update the meaning of the terms or to make them consistent with other LSC regulations.

The term LSC Support is revised to clarify that it means the sum of the recipient's LSC carryover funds from the prior fiscal year, the amount of the recipient's LSC grant for the year in question, and any LSC derivative income earned by the recipient during the year in question. The reference to derivative income is revised to be consistent with the definition of the term in Part 1630.

The proposed definition of fund balance amount is intended to clarify that the term means the excess of LSC support over expenditures as determined by the recipient's annual audit. Additional language in the current definition is proposed to be deleted because it does not constitute a statement of the meaning of the term.

No revisions have been proposed for the definition of the term fund balance percentage.

The definition of recipient is proposed to be revised to reflect current law which limits grants for financial assistance to those authorized by Section 1006(a)(1)(A) of the LSC Act. The definition is consistent with the definition of the term in many of the rules promulgated by the Corporation since 1996.

Section 1628.3 Policy

This proposed section sets out the Corporation's policies governing recipient fund balances. Several provisions in this section are found in other sections of the current rule. They have been moved to this section because they are statements of policy and are more appropriately included here. In addition, procedural provisions in the current rule have been removed from this section and transferred to the section on procedures.

Paragraph (a) states that recipients may automatically retain a fund balance up to 10% of their LSC support. Paragraph (b) clarifies that recipients may request a waiver from the Corporation to maintain a fund balance up to 25% of their LSC support. Paragraph (c) states that the Corporation has discretion to grant a waiver under paragraph (b) and clarifies that the Corporation's decision to grant a waiver must be based on the criteria found in § 1628.4(e).

Public comments, citing the practice of nonprofit corporations to retain higher fund balances, urged raising the 10% and 25% caps or eliminating the 25% cap altogether. The LSC Inspector General, on the other hand, expressed concern that large fund balances create the risk of fraud or defalcation of funds. Another comment cautioned that appropriated funds should generally be expended within the appropriation period for the badly needed provision of legal assistance for eligible clients.

The Committee decided it needs more information before deciding this issue and seeks public comment on what the appropriate level of a permissible fund balance should be and what constitutes the normal operating practice of nonprofit and government entities with regard to fund balances.

Paragraph (d) requires that any fund balance in excess of what is permitted by this rule must be returned to the Corporation. The Corporation has discretion to determine, after consultation with the recipient, whether the repayment of an excess fund balance should be made in a lump sum or in pro rata deductions from the recipient's grant checks for a specified number of months.

Paragraph (e) clarifies that the recovery of an excess fund balance does not constitute a termination pursuant to Part 1606.

Paragraph (f) clarifies that funds from one-time or special purpose grants may not be carried over as part of a recipient's fund balance. Instead, any expended funds from such grants remaining after the termination date of

the grant must be returned to the Corporation.

Section 1628.4 Procedures

This section sets out the procedures applicable to recipient fund balances. It has been revised to provide the basis on which the Corporation will exercise its discretion to grant a waiver of an excess fund balance and sets forth requirements that are intended to ensure careful oversight by the Corporation of a recipient's fund balance. All procedural requirements in the current rule have been moved to this section.

Paragraph (a) sets out the obligation of a recipient whose fund balance is in excess of the 10% ceiling to request a waiver from the Corporation within 30 days of the issuance of the recipient's final audit. The current rule requires that the statement be provided to the Corporation within 120 days of the close of the recipient's fiscal year. This is changed to link the deadline for the waiver request to the audit submission date rather than the end of the recipient's fiscal year. This will allow for periodic changes in the required submission dates for audits without a need to revise this rule. This paragraph also clarifies that, unless the recipient seeks and is granted a waiver to maintain a fund balance over the 10%, the funds will be recovered by the Corporation.

Paragraph (b) clarifies that the Corporation will review recipients' final audits, fund balance statements and any requests for waivers and will provide written notice to any recipient whose fund balance amount is due and payable to the Corporation. The written notice will include the method of repayment of any funds to be recovered.

Paragraph (c) sets out the procedures for requesting a waiver of the 10% ceiling. Generally, a recipient must specify its fund balance amount, the reasons the fund balance has accrued, the recipient's plan for the use or reserve of the fund balance within the current grant year and the circumstances justifying the retention of the fund balance.

A new provision is proposed for this paragraph that would require a recipient who seeks a waiver to retain a cash reserve to replace or update the recipient's information technology systems pursuant to paragraph (e)(4) of this section to submit a Technology Investment Plan (TIP) that outlines how and when the funds would be used to improve the recipient's Information Technology resources. See discussion of paragraph (e)(4) below.

Paragraph (d) prohibits a recipient from expending an excess fund balance

prior to receiving approval of its waiver request.

Paragraph (e) sets out the standards governing the Corporation's decision to grant a waiver. A proposed substantive revision to this paragraph establishes a different standard for determining whether to grant a recipient a waiver to retain a 25% fund balance. The new standard is intended to provide the Corporation with more flexibility and discretion to decide whether recipients may maintain a fund balance. Experience has shown that "extraordinary circumstances" is too high a standard. The underlying rationale for regulating fund balances is to ensure that recipients provide effective and economical legal assistance. While prohibiting recipients from carrying over too large a fund balance promotes this purpose, regulated use of carryover funds under certain circumstances also promotes the same purpose. Based on changing needs and the Corporation's experience with fund balances since 1984, this proposed paragraph is intended to reflect both generally and specifically the circumstances under which the Corporation may grant a fund balance waiver.

The overriding standard to be considered by the Corporation is whether the waiver would promote the statutory mandate that recipients provide high quality legal services in an effective and economical manner. In addition, the Corporation must consider 5 other factors. The first factor is consideration of any emergencies or unusual or unexpected occurrences or circumstances giving rise to the existence of the excess fund balance. The reference to "extraordinary circumstances" has been changed to "circumstances" to be consistent with the rule's other changes to the standards proposed for determining whether to grant a waiver. In addition, language providing examples of extraordinary circumstances has been deleted.

No revisions are proposed for factor two which requires consideration of any special needs of clients.

Factor three has been revised. The revision merges provisions in the current rule which deal with compensated private bar programs. See § 1628.3(d) and § 1628.4(d)(2). The current language is unclear and somewhat inconsistent. It appears to require the Corporation to grant a waiver for a cash reserve for compensated bar programs, while at the same time, it gives discretion to grant the waiver because it is granted only if there is a need for the cash reserve and after the recipient makes a timely

request. This proposed rule gives the Corporation discretion to grant the waiver after consideration of whether there is a need for the cash reserve.

Factor four is new and would give the Corporation discretion to grant a waiver so that a recipient could retain a cash reserve to replace or update the recipient's information technology systems. To carry out its statutory responsibility to encourage the most efficient and productive delivery of legal services possible, the Corporation encourages programs to invest in technology such as computers, networking equipment and advanced telephone systems. Investments in such technology can significantly increase the capability of programs to serve their clients effectively and efficiently. Computer based systems can help recipients manage legal work more efficiently. Improved technology can increase the efficiency and effectiveness of intake and pro se and community legal education efforts to make legal services more accessible. Access to the Internet can increase the quality of legal work by facilitating coordination among advocates and increasing access to available legal information and other pertinent databases.

For programs to take advantage of such opportunities generally requires significant purchases of hardware and software. The Corporation believes that the best practice for management of information technology is to replace computer and information management technology on a regular, ongoing basis. Currently, however, significant new technological capacities are developing at an extremely rapid rate that suggest that radically transformative technology may emerge periodically during the coming years. The unexpected development and universal adoption of the world wide web as a principal instrument of business and government is an example of such a development. Most planners agree that for programs to keep up with these expanding possibilities, they should be prepared to replace computer equipment completely on a regular cycle, which may be as often as every three years. There may be occasions, therefore, when normal incremental upgrading of technological resources is not enough and a disproportionately significant investment is required because of the need to replace all the program's equipment and software.

Programs that plan to purchase large amounts of computer equipment are often faced with the barrier that they can only maintain a fund balance of 10% or less and cannot create a property replacement reserve, if the

resulting fund balance should exceed 10%. The Corporation proposes to amend Part 1628 to allow it to waive the 10% ceiling so that, with proper safeguards, recipients can maintain such a property reserve fund. The Corporation believes that such a waiver for recipients to update their equipment in an orderly and efficient manner will promote more effective planning and will encourage more effective and efficient delivery of services to clients.

The final factor considered by the Corporation is the recipient's financial management record.

Paragraph (e) is new and provides tighter controls on the use of fund balances by recipients. It states that the Corporation's approval must require the recipient to use the funds within a specified time period and must use the funds for the purposes set out in the waiver request as revised by the Corporation's approval.

Paragraph (f) is a reporting requirement for any fund balance retained by a recipient pursuant to a waiver.

Section 1628.5 Fund Balance Deficits

Only technical changes have been made to this section either to update the information or to make it consistent with the rest of the rule. Generally, this section regulates recipient deficits. Deficits are discouraged and use of LSC funds to liquidate a deficit requires prior Corporation approval. Any LSC funds used to liquidate a deficit shall be identified as questioned costs unless prior approval for such use has been provided by the Corporation.

List of Subjects in 45 CFR Part 1628

Legal services, Fund balances.

For reasons set out in the preamble, LSC proposes to revise 45 CFR part 1628 to read as follows:

PART 1628—RECIPIENT FUND BALANCES

- Sec.
1628.1 Purpose.
1628.2 Definitions.
1628.3 Policy.
1628.4 Procedures.

§ 1628.5 Fund balance deficits.

Authority: Secs. 42 USC 2996e(b)(1)(A), 2996f(a)(3).

§ 1628.1 Purpose.

The purpose of this part is to set out the Corporation's policies and procedures applicable to recipient fund balances. The Corporation's fund balance policies are intended to ensure the timely expenditure of LSC funds for the effective and economical provision

of high quality legal assistance to eligible clients.

§ 1628.2 Definitions.

- (a) "LSC support" means the sum of:
- (1) The carryover LSC fund balance from the prior fiscal year;
 - (2) The amount of financial assistance awarded by the Corporation to the recipient for the fiscal year in question; and
 - (3) Any LSC derivative income, as defined in § 1630.2(c), earned by the recipient for the grant year in question.
- (b) The LSC "fund balance amount" is the excess of LSC support over expenditures as determined by the recipient's annual 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 grantee or contractor receiving financial assistance from the Corporation under section 1006(a)(1)(A) of the LSC Act.

§ 1628.3 Policy.

- (a) Recipients are permitted to retain from year-to-year fund balances up to 10% of their LSC support.
- (b) Recipients may request a waiver to retain a fund balance up to a maximum of 25% of their LSC support.
- (c) A waiver pursuant to paragraph (b) of this section may be granted at the discretion of the Corporation pursuant to the criteria set out in § 1628.4(e).
- (d) Any fund balance amount in excess of 10% of LSC support shall be repaid to the Corporation. If a waiver of the 10% ceiling is granted, any fund balance amount in excess of the amount permitted to be retained shall be repaid to the Corporation. Repayment shall be in a lump sum or by pro rata deductions from the recipient's grant checks for a specific number of months. The Corporation shall determine which of the specified methods of repayment is reasonable and appropriate in each case after consultation with the recipient.
- (e) A recovery from LSC support to recover an excess fund balance pursuant to this part does not constitute a termination under 45 CFR part 1606. See § 1606.2(c)(2)(ii).

(f) All one-time or special purpose grants awarded by the Corporation shall have an effective date and a termination date. Such grants are not subject to this part's 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 Procedures.

(a) Any recipient whose audited fund balance exceeds the 10% ceiling set forth in § 1628.3 shall submit to the Corporation, within 30 days of the issuance of the recipient's final audit, a statement of the fund balance which occurred according to the required annual audit. The funds will be recovered as set forth in § 1628.3(d) unless the recipient requests and is granted a waiver by the Corporation.

(b) After the Corporation's receipt and review of the recipient's annual audit, the recipient's fund balance statement pursuant to paragraph (a) of this section and any requests for a waiver, the Corporation shall provide written notice to the recipient of any 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 § 1628.3(d).

(c) The recipient may, within 30 days of the issuance of the recipient's annual audit, request a waiver of the 10% ceiling. Such request 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. If a waiver is requested under § 1628.4(e)(4), for updating or replacing information technology systems, a Technology Investment Plan that outlines how and when the funds will be used to improve the recipient's Information Technology resources should be provided with the waiver request;
- (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 circumstances justifying the retention of the fund balance.

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

(e) The decision of the Corporation regarding the granting of a waiver 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 consider the following factors.

(1) Emergencies or unusual or unexpected occurrences, or circumstances giving rise to the existence of a fund balance in excess of 10%;

(2) The special needs of clients;

(3) The need for a recipient that operates a compensated private bar program or component to retain a cash reserve up to 25% of the amount of direct payment to attorneys indicated in the recipient's last audit for direct payment to attorneys in the bar program;

(4) The need for the recipient to retain a cash reserve to replace or update the recipient's information technology systems; and

(5) The recipient's financial management record.

(f) The Corporation's written approval of a request for a waiver shall require that the recipient use the funds it is permitted to retain within the time period set out in the approval and for the purposes set out in the waiver request, as revised by the Corporation's approval.

(g) Excess fund balance amounts approved by the Corporation for expenditure by a recipient 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.

§ 1628.5 Fund balance deficits.

(a) Sound financial management practices such as those set out in Chapter 3 of the Corporation's Accounting Guide for LSC Recipients should preclude deficit spending. Use of current year LSC grant funds to liquidate deficit balances in the LSC fund from a preceding period requires the prior written approval of the Corporation.

(b) The recipient may, within 30 days of the issuance of the recipient's annual audit, 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 § 1628.4(c) (1) and (2). 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 circumstances giving rise to this situation.

Dated: October 16, 1998.

Victor M. Fortuno,
General Counsel.

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LEGAL SERVICES CORPORATION

45 CFR Part 1635

Timekeeping Requirement

AGENCY: Legal Services Corporations.

ACTION: Proposed rules.

SUMMARY: This proposed rule would revise the Corporation's timekeeping rule to require full-time attorneys and paralegals to provide the date as well as the time spent on each case, matter or supporting activity. In addition, timekeeping records for full-time attorneys and paralegals would be required to be consistent with the recipient's time and attendance records.

Public comment is requested on two alternative proposed requirements that would ensure that a recipient's part-time attorneys and paralegals do not engage in restricted activities during the time periods they are being compensated by an LSC recipient. The first alternative would revise the Corporation's timekeeping rule to require part-time attorneys who work for organizations that do restricted work to include additional information in their timekeeping records. In addition, their timekeeping records would be required to be consistent with the recipient's time and attendance records. The second alternative would require part-time attorneys and paralegals to certify in writing that they have not engaged in any restricted activities during the time for which they are compensated by a recipient. Comments

on these and other possible alternatives are requested.

DATES: Comments should be received on or before December 21, 1998.

ADDRESSES: Comments should be submitted to the Office of the General Counsel, Legal Services Corporation, 750 First St. NE., 11th Floor, Washington, DC 20002-4250.

FOR FURTHER INFORMATION CONTACT: Suzanne Glasow, Office of the General Counsel, 202-336-8817.

SUPPLEMENTARY INFORMATION: This proposed rule is a response to the Corporation's Office of Inspector General's (OIG) Summary Report on Audits of Selected Grantees for Compliance with Selected Regulations (February 1998). The report found that timekeeping records could not demonstrate that part-time employees of grantees do not work on restricted activities¹ during any time for which they are compensated with LSC funds for their services. In order to address this finding, the OIG recommended revising the Corporation's timekeeping rule to require that part-time attorneys and paralegals who work part-time for the recipient and part-time for an organization that engages in restricted activities (hereinafter referred to as "part-time employees") account for all hours worked for the recipient by date and time of day in their timekeeping records.

The Operations and Regulations Committee (Committee) of the Legal Services Corporation's (LSC) Board of Directors (Board) met on September 11, 1998, in Chicago, Illinois, to consider proposed revisions to § 1635.3(b)(1) of the Corporation's timekeeping rule intended to provide records that more clearly demonstrate that part-time employees have not engaged in any restricted activities during the time for which they are compensated by the recipient. At the meeting, a certification requirement was suggested as an alternative to revising the timekeeping rule. The Committee decided to publish both the proposed timekeeping rule and the alternative certification requirement in this rule for public comment before making any decision on which is the better alternative. In addition, the Committee requests comments on any

¹ For the purposes of this requirement, the term restricted activities is an umbrella term that refers to the restrictions listed in the definitions of purpose prohibited by the LSC Act and activity prohibited by or inconsistent with section 504 in 45 CFR § 1610.2(a) & (b). A particular activity is restricted only to the extent it is limited pursuant to statutory or regulatory law. Nothing in this rule is intended to expand on the scope of any restriction or the type of recipient funds implicated by a particular restriction.