

LEGAL SERVICES CORPORATION**45 CFR Part 1630****Cost Standards and Procedures****AGENCY:** Legal Services Corporation.**ACTION:** Proposed rule.

SUMMARY: The proposed rulemaking establishes a new Part 1630 prescribing standards and procedures for determining allowable cost for grants and contracts under section 1006 of the Legal Services Corporation Act (Act), and for recovering disallowed costs. The Corporation has relied on the standards and procedures contained in the Audit and Accounting Guide for Recipients and Auditors (Audit Guide), and LSC Instruction 83-8, of November 23, 1983, entitled "Standard Operating Procedure for Questioned Costs." The Audit Guide was published on November 29, 1985 [50 FR 49276]. These new standards and procedures are intended to give recipients clear and simple standards and procedures to know what costs are allowable, which costs require prior approval, how that approval is obtained, and how to obtain review of disallowed costs.

DATE: Comments must be received on or before May 21, 1986.

ADDRESS: Comments may be submitted to the Office of General Counsel, Legal Services Corporation, 400 Virginia Avenue SW., Washington, DC 20024-2751.

FOR FURTHER INFORMATION CONTACT: John H. Bayly, Jr. General Counsel, (202) 863-1820.

SUPPLEMENTARY INFORMATION: The Corporation has been working for some time through the "Audit and Appropriations" and "Operations and Regulations" Committees of the Board of Directors, and corporate staff, to improve accountability over the federal funds entrusted to the Corporation. The evident need for clear and concise standards, governing the determination of allowable costs to recipients for program funds and for the recovery of misspent tax dollars, became abundantly clear in the process of developing a comprehensive revision of the Audit Guide, and in the processing of allowable cost disputes. Proposed rules were issued for comment on August 29, 1985 [50 FR 35102] and several comments were received. Useful information was developed, and the programs had an opportunity to give their views. In the process of taking a wider look at sources, the Corporation is exploring the wealth of guidance and experience developed by the Federal

executive agencies in their efforts to safeguard tax dollars and assimilated into the various circulars of the Office of Management and Budget (OMB). Circulars A-122, ("Cost principles for Non-profit Organization") and A-110 ("Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education Hospitals, and Other Non-profit Organization") were particularly instructive.

These proposed regulations follow the standards and policies of the Circulars to the extent practicable. We have not, however, rigidly followed the circulars for the sake of consistency or to avoid the work of making our own hard choices. These circulars are the product of many years of experience, much trial and error, and many separate voices. We would be short sighted not to use them to the extent possible. After all, their purpose, like ours, is to assure accountability for tax dollars.

The principal elements of the proposed rules are as follows

(1) *Governing Standards:* Sec. 1630.4 sets forth the applicable standards and criteria. Thus, costs must be actual and the recipient must be liable for payment, and costs must be reasonable and necessary, and in compliance with the Act, applicable appropriations acts, relevant rules and regulations, and the Audit Guide. They must also be consistent, uniformly applied, and in accord with generally accepted accounting principles. They cannot be used to match other federal dollars unless such use is legally permitted and they must be adequately documented.

Recipients must avail themselves of applicable credits, such as discounts, rebates, insurance refunds and recoveries. They must account for all program income, including attorneys' fees, and apply such income as a credit against the Corporation award. They may work out an advance understanding with the Corporation to avoid uncertainty about cost allowability.

(2) *Unallowable Costs:* Under §1630.5, unallowable costs are:

(a) Cost incurred in violation of statute, implementing rules and regulation, or the terms of the recipients award.

(b) Certain distant, out-of-state travel, without Corporation approval that is not closely related to the fundamental purpose of Corporation funding: Provision of direct legal services to eligible clients. Travel for lobbying (under the narrow exceptions permitted by Congress), training (often used in the past as a cover for political organizing),

and other permitted non-litigation functions need to be held to a reasonable proportion of funding so that the resources of grantees may be concentrated on direct delivery of legal services to clients. The time limits for the Corporation to act on request for approval have been shortened for travel requests and the Corporation would expect to act promptly in all such requests and to average no more than a few working days and as promptly as necessary for written or oral requests that state a reasonable need for immediate action.

(3) Without prior approval, certain expenses connected with lobbying, legislative advocacy and formal rule making;

(4) The use of funds provided by the Corporation for the expenses of litigation against the Corporation. Although some have argued that Congress specifically intended to allow such use of funds appropriated for legal services to eligible clients, they have not provided references to the legislative history and we are not aware of any reason to believe that this was intended by Congress. It is, of course, our intent to conform as precisely as possible to Congressional intent. One obvious reason that litigation regarding denial of refunding has taken a long time to resolve even where the merits of the case are clear cut is that a recipient's management has no incentive to settle. Instead, recipients can litigate and simply reduce services to clients to cover the costs of complicating and delaying the inevitable. The provision is similar in intent to provisions in federal regulations concerning grants to non-profit organizations. See OMB Circular A-122, attachment B.34(d), 45 FR at 46031 (July 8, 1980). The Corporation is considering incorporating this and other relevant federal grant regulations into this regulation by reference except where they are inconsistent with specific laws relevant to the Corporation.

(5) Without prior approval, attorneys' fees in other cases involving recipients such as labor disputes.

(6) Without prior approval, (a) leases and purchases in excess of \$10,000 for single or combined purchases;

(b) purchases of real property; and (c) certain consultant contracts in excess of \$5000 or \$261 per 8-hour day, or \$35.00 per hour.

(3) *Burden of Proof:* The recipient has the burden of proof. Where it claims that funds were not subject to a restriction, it also has the burden of proof on that issue. Where a restriction applies to

funds which are commingled, or where it applies to one of two or more funds for the same or similar payments, there is a rebuttable presumption that the restriction applies to all the funds.

Review and Appeal: Under § 1630.7 the Corporation may question a cost by notifying a recipient who may respond within 30 days. The Corporation has 45 days thereafter to make a decision. The recipient may appeal the decision to the President within 30 days, and the President then has 30 days to make a final decision on the record. Under § 1630.8, disallowed funds are recovered from future checks or by direct payment or otherwise. The Corporation is considering combining, shortening, and streamlining the procedures set forth in § 1630.7 and .8; the Corporation could provide a notice that provides the facts and reasons for questioning a cost, the recipient could make one response, and then one decision could be made.

Other Matters: The Corporation cannot claim lack of prior approval where it fails to act on time (§ 1630.6). It must require recipients to take corrective action to avoid recurrences and it may take other action under parts 1606, 1623 and 1625 for more serious financial irregularities (§ 1630.9). It may also make appropriate referrals such as to law enforcement agencies and bar associations. Recovery of a questioned cost is not to be construed as a termination or a denial of refunding under parts 1606 or 1625. Under § 1630.10, where expenditures under subgrants or subcontracts are disallowed, the subrecipient or subcontractor is jointly and severally responsible and subject to the same remedies as the recipients.

List of Subjects in 45 CFR Part 1630

Accounting, government contracts, grant programs, legal services.

For the reasons set out in the preamble, 45 CFR Chapter XVI is proposed to be amended by adding Part 1630 as follows:

PART 1630—COSTS STANDARDS AND PROCEDURES

Sec.

1630.1 Purpose.

1630.2 Definitions.

1630.3 Burden of proof presumption.

1630.4 Standards governing allowability of costs.

1630.5 Costs specifically unallowable.

1630.6 Effect of absence of prior approval.

1630.7 Review and appeal process.

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1630.9 Other remedies, effect on other parts.

1630.10 Responsibility of Subgrantees and Subcontractors.

1630.11 Time

Authority: Sec. 1006(b) (1), (2), (3) and (5), 1007(a) (3) and (9), 1007(d), 1008(e), 1010(c), and 1011 of the Legal Services Corporation Act, as amended (42 U.S.C. 2996e(b) (1), (2), (3) and (5), 2996f(a), (3) and (9), 2996f(d), 2996g(e), 2996i(c) and 2996(j)).

§ 1630.1 Purpose.

This part is intended to provide uniform standards for allowability of costs and to provide a comprehensive, fair, impartial, timely and flexible process for the resolution of questioned costs incurred by recipients of the Corporation. It is the intent of the Corporation to conform these requirements, where appropriate, to the policies developed over years of Federal experience with grants to nonprofit organizations.

§ 1630.2 Definitions.

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

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

(c) A "disallowed cost" is a cost which has been determined to be ineligible for payment from a recipient's Corporation or non-public funds, or both, including any income the recipient may have derived from the activities supported by that cost, including proceeds from the sale of assets purchased with those funds, and interest on those funds.

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

§ 1630.3 Burden of proof presumption.

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

(b)(1) 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 proof that the funds actually expended were not in fact subject to that restriction.

(2) Where a recipient or subrecipient has placed funds subject to a restriction contained in a federal statute, a Corporation rule, regulation, instruction or guideline, or in an award condition in the same account with funds not subject to such restriction, or where funds in separate accounts are controlled by the same person or are under common control, and from the time the recipient first placed funds subject to the restriction in one of the accounts, clear,

objective, prior standards have not been followed consistently as to what expenses will be paid from which account, it will be a rebuttable presumption that the restriction applies to all the funds in the account or accounts.

§ 1630.4 Standards governing allowability of costs.

(a) **General Criteria.** Expenditures by a recipient are allowable under the recipient's award only if the recipient can demonstrate that the expenditure was:

(1) Actually incurred after the effective date of the award 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 specially approved in the terms and conditions of the award;

(3) Allocable to such function(s);

(4) In compliance with the Act, applicable appropriation acts, Corporation regulations, guidelines and instructions, the ISC Audit and Accounting Guide for Recipients and Auditors, and the terms and conditions of its award;

(5) Consistent with policies and procedures that apply uniformly to both the 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 Corporation or Federally financed program in either the current or a prior period, except as otherwise permitted by law; and

(9) Adequately and contemporaneously documented and the documentation was made available to the Corporation from normal business records without an opportunity for alteration;

(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 costs. The question of the reasonableness of specific costs must be scrutinized with particular care in connection with organizations or separate divisions thereof which receive the preponderance of their support from awards made by Corporation or Federal agencies. 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 organization or the performance of the award.

(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 terms and conditions of the award.

(3) Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its members, employees, clients, the public at large, the Corporation, and the Federal Government.

(4) Significant deviations from the established practices of the organization which may unjustifiably increase the award 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 award 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 award.

(ii) Benefits both the award and other work and can be distributed in reasonable proportion to the benefits received, or

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

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

(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 an award from the Corporation.

(2) The term "applicable credits" refers to those receipts or reduction of expenditures which operate to offset or reduce expense items that are allocable to awards 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 or received by the recipient relate to allowable costs they shall be credited to the award 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. All such program income received during the project period must be applied as a credit against grant or contract costs charged the Corporation.

(f) *Advance understandings.* Under any given award the reasonableness and allocability of certain items of costs may be difficult to determine. This is particularly true in connection with organizations that receive a preponderance of their support from LSC. 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 the incurrence of 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" of an unallowable cost, 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.

§ 1630.5 Costs specifically unallowable.

The following costs are specifically unallowable:

(a) A cost charged to Corporation funds in violation of the Act, other provisions of law, Corporation rules, regulations or guidelines, or the terms of a recipient's grant or contract agreement; or a cost charged to other non-public funds in violation of the Act or Part 1610 of these regulations;

(b) A cost charged to Corporation funds allocable to out-of-state travel beyond 150 miles from a recipient's office that is not on behalf of an eligible client for the purpose of conducting necessary legal investigation and discovery or for the purpose of appearing on behalf of an eligible client in a state or Federal court or before an administrative agency in an adjudicatory matter, without the prior approval of the Corporation. Normally, approval should be requested sufficiently far in advance to be

received in writing, but verbal approval followed by a written request for confirmation is acceptable if there is a legitimate need for such travel on short notice;

(c) Without the prior written approval of the Corporation, the following expenditures, if incurred wholly or partially for the purpose of conducting, or supporting legislative advocacy, formal rulemaking or lobbying:

(1) Expense of office space separate from a recipient's principal office, except for branch offices used primarily for direct client service (the approval must be explicit and can be no more than 12 months prior to the payment);

(2) Travel expenditures over \$100; and

(3) Conduct of or attendance at meetings and conferences.

(d) Cost of counsel to represent a recipient (1) in a matter in which the Corporation is an opposing party or has an opposing interest (but a recipient may use other non-public funds for payment of such fees), or (2) without prior approval, in other law suits or labor disputes to which recipient is a party.

(e) The following costs if incurred without the prior written approval of the Corporation:

(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 a 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 \$35.00 per hour except that audit service shall not be considered as consultant services, but other services that may be provided by a recipient's auditor, such as the

production of write-up costs or the preparation of interim financial reports shall be considered consultant services and shall require approval if the fees exceed the limits established by this part.

§ 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 or non-public funds, or a proposed action that could result in a cost expenditure that the recipient will charge to Corporation or non-public funds, within sixty (60) days (or fifteen (15) days of the request is for approval of travel) of the 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 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 reasons for questioning it. Such notice must be provided no more than 6 years after the recipient incurred the cost or expended the funds. To obtain relevant information while investigating a questioned cost, the Corporation may contact any party it deems necessary. If the recipient fails to respond within 30 days of its receipt of notice, the cost shall be disallowed.

(b) 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.

(c) Within thirty (30) days after it receives notice from the Corporation that a questioned cost has been disallowed, a recipient may file a written notice of appeal with the President of the Corporation, stating in detail its reasons for requesting review.

(d) Within thirty (30) days after receipt of the written notice of appeal, the President shall either adopt, modify, or reverse the decision of disallowing the cost. The decision shall be based on the written record, including the recipient's notice of appeal, and any response and analysis by Corporation 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 appeal shall be based on the written record, the recipient's notice of appeal, and any response and analysis by Corporation staff. The recipient shall be provided with a copy of the record if requested. The President shall have no prior involvement in the consideration of the particular questioned cost in issue. If the President has had such prior involvement, the President shall designate another executive employee who has no prior involvement to hear and decide the appeal.

§ 1630.8 Recovery of disallowed costs.

(a) Within thirty (30) days after receipt of notice from the Corporation that a questioned cost has been disallowed, the recipient may where it chooses not to protest the decision of the Corporation under § 1630.7 above, show in writing why the Corporation should not for equitable, practicable or other reasons, recover the amount of the disallowed cost. If the recipient fails to respond within the prescribed time, 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. If the disallowed cost is a charge to non-LSC funds in violation of the LSC Act or Part 1610 of these regulations, the Corporation shall recover from the recipient's LSC funds an amount not to exceed the amount of the total disallowed cost and any additional income derived therefrom.

(b) If the recipient has demonstrated, pursuant to paragraph (a) of this section, that recovery of the funds as provided therein is inappropriate, the Corporation, within forty-five (45) days after it receives the recipient's written response, may:

(1) Recover less than the total amount of the disallowed cost through reduction of the amount of monthly grant checks; or

(2) Require the recipient to reimburse its LSC fund from another source or accept the recipient's demonstration that it has reimbursed its LSC fund from a funding source from which the original

expenditure could have been made without a violation of Sec. 1010(c) of the Act (42 U.S.C. 2996(c)) or Part 1610 of the regulations.

§ 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 the recurrence of the activity that gave rise to such disallowed costs. In cases of serious financial mismanagement, fraud or defalcation of funds, the Corporation shall 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 as 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 LSC 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 (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 notify the recipient in writing.

Dated: April 17, 1986.

John H. Bayly, Jr.,

General Counsel.

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FEDERAL MARITIME COMMISSION

46 CFR Parts 580 and 581

[Docket No. 86-6]

Service Contracts

AGENCY: Federal Maritime Commission.