

#### LEGAL SERVICES CORPORATION

##### Accounting Guide for LSC Recipients (2010 Edition)

**AGENCY:** Legal Services Corporation.

**ACTION:** Notice.

**SUMMARY:** The Legal Services Corporation (LSC) is revising the Accounting Guide for LSC Recipients to reflect changes that have occurred since the last publication of the Accounting Guide (the "Guide") in 1997. Notice was published in the **Federal Register** on February 2, 2010, requesting public comments to proposed revisions to the Guide. Following the receipt of comments from the public, the LSC Office of the Inspector General and members of the LSC Board of Directors, and making changes as deemed appropriate in response to those comments, the LSC Board of Directors approved revisions to the Guide at a meeting held on June 15, 2010.

The revisions incorporate: (1) New internal control provisions for electronic banking transactions and contracting; (2) financial oversight concepts from the Sarbanes Oxley Act of 2002; (3) references to the accounting standards codification by the Financial Standards Accounting Board (FASB) released on July 1, 2009; (4) key practices to enhance fraud prevention; (5) provisions in other LSC regulations and policies, including the LSC Property Acquisition and Management Manual and LSC Program Letters; (6) revisions to accounting procedures and internal controls to reflect current best practices; (7) updated and new

references to other sources of information; and (8) other changes to clarify existing provisions. The Accounting Guide for LSC Recipients (2010 edition) can be located by accessing LSC's Web site at [http://www.lsc.gov/pdfs/accounting\\_guide\\_for\\_lsc\\_recipients\\_2010\\_edition.pdf](http://www.lsc.gov/pdfs/accounting_guide_for_lsc_recipients_2010_edition.pdf).

**DATES:** *Effective Date:* August 23, 2010.

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#### SUPPLEMENTARY INFORMATION:

##### Background

Under the Legal Services Corporation Act, as amended, LSC "is authorized to require such reports as it deems necessary from any recipient, contractor or person or entity receiving assistance" 42 U.S.C. 2996g(a). LSC is also "authorized to prescribe the keeping of records with respect to funds provided by grant or contract and shall have access to such records" 42 U.S.C. 2996g(b). Further, LSC "shall conduct or require each recipient, contractor, person or entity receiving financial assistance \* \* \* to provide for an annual financial audit." 42 U.S.C. 2996h(c)(1). In addition, "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" 42 U.S.C. 2996i(c).

Under authority of the Legal Services Corporation Act, LSC published the Accounting Guide for LSC Recipients. The Guide sets forth LSC's accounting, financial management and reporting guidelines. In general, LSC requires recipients and subrecipients 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 generally accepted accounting principles (GAAP). The current version of the Guide was last updated in 1997.

In an effort to update the Guide to reflect more current accounting and financial oversight practices, as well as to respond to grantee financial issues mentioned in a Government Accountability Office (GAO) report, and as a result of the recommendations of the LSC Fiscal Advisory Group, LSC developed a number of revisions to the Guide. The revisions are in the following eight categories:

(1) *New internal control provisions for electronic banking transactions and contracting.* The current Guide does not discuss in detail electronic banking. Electronic banking arrangements and transactions are now common. Many recipients of LSC funding conduct a significant portion of their financial transactions electronically. LSC itself transmits funds electronically to all recipients. The revisions add a new section on electronic banking to the Fundamental Criteria and include sections on the authorization process for electronic banking activities, the authorization process for employees that initiate and transmit electronic fund transactions, review and approval procedures for electronic banking transactions, supporting documentation for electronic banking transactions, recording electronic banking transactions in the general ledger, bank reconciliations and safeguards. Section 3–5.15. New sections on electronic transactions have also been added to the Accounting Procedures and Internal Control Checklist in Appendix VII. Sections G2, G3, and M of Appendix VII. In addition, a new section was added in the Fundamental Criteria on contracting and includes sections on types of contracts, documenting, competition and approvals. Section 3–5.16.

(2) *Financial oversight concepts from the Sarbanes Oxley Act of 2002.* While only limited provisions of the Sarbanes Oxley Act of 2002 are required of non profit corporations, LSC has determined that certain financial oversight concepts found in Sarbanes Oxley are appropriate for recipients of LSC funds. An example is the current Accounting Guide requirement that recipients of LSC funds have a financial oversight committee of their board of directors, but not a separate audit committee. The revisions require that recipients must have a financial oversight committee(s) that engages in all the activities of an audit committee, including: Hiring the auditor; setting the auditor's compensation; overseeing the auditor's activities; setting rules and processes for complaints about accounting practices and internal control practices; reviewing the annual IRS Form 990 for completeness, accuracy, and on-time filing and providing assurances of compliance to the full board; ensuring the recipient's operations are conducted and managed in an ethical manner that complies with all applicable laws, regulations and policies; ensuring effective management of the recipient's resources and risks; and ensuring accountability of persons within the

organization. Section 1–7. In addition, the revisions consider it a *best practice* for the board of directors to have an audit committee separate from the finance committee and for the board to have at least one member who is a financial expert or for the board to have access to a financial expert. Section 1–7.

(3) *References to the accounting standards codification by the Financial Standards Accounting Board (FASB).* FASB released a new codification of its accounting standards on July 1, 2009. The standards, an authoritative listing of generally accepted accounting principles (GAAP), are referred to in numerous sections of the Guide. All references to the accounting standards in the Accounting Guide have been updated and new references have been inserted to reflect new section numbers in the FASB accounting standards codification.

(4) *Key practices to enhance fraud prevention.* While the current Guide lists the elements of an adequate accounting and financial reporting system, including the use of specific internal controls and risk assessment, there is no separate section on fraud prevention. The revisions add a fraud prevention section that details key practices to help prevent fraud. Section 3–6.

(5) *Provisions in LSC regulations and policies, including the LSC Property Acquisition and Management Manual and LSC Program Letters.* The regulation on attorneys' fees (45 CFR Part 1642) was eliminated in a final rule change effective April 26, 2010, to reflect changes contained in the Consolidated Appropriations Act of 2010, Public Law 111–117. Accordingly, section 2–2.6 (Court-Awarded Attorney Fees) of the Guide was modified. Further, subsequent to the publication of the Guide in 1997, LSC issued other guidelines for recipients of LSC funds that impact on the Guide. For example, the LSC Property Acquisition and Management Manual (PAMM), issued in 2001, requires recipients to capitalize and depreciate all nonexpendable property with a cost in excess of \$5,000 and a useful life of more than one year. However, the current Guide uses \$1,000 as the capitalization and depreciation threshold. The revisions to the Guide change the threshold to \$5,000 to be consistent with the PAAM. Appendix IV, Section 1. In addition, LSC has issued Program Letters 08–2 (March 20, 2008), 08–3 (December 18, 2008) and 09–3 (December 17, 2009) that contain guidance to recipients on compliance and fiscal management issues. Those Program Letters have been referenced in

the revisions to the Guide. Section 2–3.1.

(6) *Revisions to accounting procedures and internal controls to reflect current best practices.* Appendix VII of the current Guide contains a checklist of accounting procedures and internal controls. The revisions update the checklist to reflect current best practices.

(7) *Updated and new references to other sources of information.* The Guide contains numerous references to other sources of information. The revisions update and make new references where appropriate.

(8) *Other changes to clarify existing provisions.* The revisions clarify existing sections to make the provisions easier to understand.

#### Comments Received to Proposed Revisions to Accounting Guide

Following the publication of notice of proposed revisions to the Guide in the **Federal Register** on February 2, 2010, LSC received comments from the public, the LSC Office of the Inspector General, and from members of the LSC Board of Directors. The following is a summary of comments received and LSC's response to those comments.

#### Responsibilities of the Financial Oversight Committee of Committees (Section 1–7)

Section 1–7 sets forth the duties and responsibilities of financial oversight committees, including the finance and audit committees. The Georgia Legal Services Program raised a concern about the prospect of being required to have separate board finance and audit committees. *Response:* The proposed revisions do not require separate finance and audit committees. Section 1–7 provides that "it generally is considered a best practice for governing bodies to have both a finance committee and a separate audit committee." However, the proposed revisions do provide that "[t]he critical point is that all of the finance and audit committee duties \* \* \* must be performed by a financial oversight committee(s)."

The Georgia Legal Services Program also expressed concern over the use of the term "financial statements" in one of the specified roles of the finance committee. The Georgia program mentions that the review of full financial statements monthly would be time-consuming, burdensome for the program, and potentially confusing. *Response:* In response to this comment we have revised this section to use the term "management reports" rather than "financial statements" in role No. 2 of the finance committee, with a reference

to budgeted and actual expenses and income, variances, and a statement of cash on hand. We have added sample management reports as Appendix IB and a section entitled "Statement of Cash on Hand" to section 3–5.9 of the Fundamental Criteria (Management Reports).

The final comment from the Georgia Legal Services Program is that the provision of financial reports on a quarterly basis, rather than monthly as set forth in the proposed revision, has worked well for their program.

*Response:* While it is recognized that a number of programs provide financial reports to the finance committee and/or the board on a quarterly basis, it is the preferred practice to have these reports produced and reviewed monthly thereby providing the finance committee with as up-to-date information as possible on the financial condition of the program. It should be noted that this provision does not require monthly meetings of the finance committee, but that the reports be reviewed monthly with the chief financial officer, controller, and/or CPA. This review may occur by email or in some other manner.

In addition, there were comments from several members of the LSC Board of Directors that this section needs to have more focus on the need for the duties of audit committees to be performed even if a recipient does not have a separate audit committee and on the need of having a financial expert on the financial oversight committee(s) or access to a financial expert. One board member also mentioned that there were too many "or" options in the language. *Response:* In response to these comments, a new paragraph has been drafted which more clearly emphasizes the critical points that all of the listed duties of a finance and an audit committee must be performed by a financial oversight committee(s) and that the financial oversight committee(s) needs to have a financial expert or access to a financial expert.

LSC Board members recommended an expansion of the language in Section 1–7 under role No. 6 of the Audit Committee. *Response:* Role No. 6 of the Audit Committee in Section 1–7 was expanded to more fully describe the committee's duties in ensuring compliance with ethical requirements, applicable laws, regulations and policies, effective management of the recipient's resources and risks, and accountability of persons within the organization.

#### Property (Section 2–2.4)

Section 2–2.4 sets forth certain principles for the treatment of property, including the requirement that recipients capitalize and depreciate all nonexpendable property with a cost in excess of \$5,000 and a useful life of more than one year. A comment was received from the LSC Office of the Inspector General (OIG) suggesting that it might be necessary to include accounting for sensitive assets even when those assets are valued at less than \$5,000, as the program may want to track them for other reasons.

*Response:* A new sentence has been added to Section 2–2.4 incorporating this suggestion.

#### Court-Awarded Attorneys Fees (Section 2–2.6)

Section 2–2.6 discusses court-awarded attorneys' fees. A comment was received from the Chair of the Standing Committee on Legal Aid and Indigent Defendants of the American Bar Association, suggesting that, given the elimination of the restriction on the claiming, collection and retention of attorneys' fees, it would be helpful if there would be an explanation of what attorneys' fees are permitted. *Response:* It is correctly noted that the restriction on claiming, collection and retention of attorneys' fees (former 45 CFR 1642) has been eliminated in a final rule change effective April 26, 2010, to reflect changes contained in the Consolidated Appropriations Act of 2010, Public Law 111–117, and that there is no language in the change to 2–2.6 stating in what situations attorneys' fees are permitted. The question of when attorneys' fees are permitted to be collected from the opposing party is generally a matter of state and federal law, as interpreted by the judge deciding the case. LSC does not have a regulation that sets forth when attorneys' fees are available. It is noted that the recipients of LSC funds are subject to restrictions regarding accepting fee-generating cases, as set forth in 45 CFR 1609. No change to 2–2.6 was made in response to this comment.

There was also a comment from the Center on Law and Social Policy recommending a reference in 2–2.6 to the provision on accounting for attorneys' fees, now set forth in 45 CFR 1609.4. *Response:* In response to this comment, 2.2–6 has been amended to include this reference.

#### Grant and Contract Costs (Section 2–3.1)

Section 2–3.1 addresses grant and contract costs. A comment received

from the LSC OIG questioned whether the Program Letter on Compliance Guidance and Interim Guidance on Attorneys' Fees dated December 17, 2009, was superseded by an interim final rule on attorneys' fees issued by the LSC on March 15, 2010. *Response:* The purpose of the reference to Program Letters in 2–3.1 is to let grantees know that the letters themselves contain additional cost allocation and financial management information. The Compliance Guidance and Interim Guidance on Attorneys' Fees issued on December 17, 2009 as Program Letter 09–03 mostly discusses issues unrelated to attorneys' fees. The attorneys' fees discussion is limited to interim guidance and by its terms applies only until LSC Board action on the issue. The interim guidance remains applicable during the period until the Board acted. After reviewing the Program Letter, there appears to be nothing inconsistent between the interim guidance and the Board's later action.

#### Internal Control/Fundamental Criteria of an Accounting and Financial Reporting System (Chapter 3)

The introduction to Chapter 3 discusses the responsibilities of a recipient to maintain adequate accounting records and internal control procedures. An LSC OIG comment recommended the addition of language making clear that internal control is specifically a management responsibility. *Response:* The first paragraph of Chapter 3 has been modified to add that internal control is "managed and maintained by the recipient's board of directors and management."

#### Fundamental Criteria (Section 3–5)

Section 3–5 contains the LSC Fundamental Criteria, which is a listing of the elements of an adequate accounting and financial reporting system. A comment from the LSC OIG noted that the discussion on Enterprise Risk Management seemed to be misplaced and not fully developed. *Response:* As a result of this comment, we have revised section 3–5 to include a fuller discussion of Enterprise Risk Management in the background section.

An additional comment from the OIG suggested that a section on contracting should be included in the fundamental criteria. *Response:* In response to this comment a new section on contracting has been added to the Fundamental Criteria. See Section 3–5.16.

A further OIG comment stated that while allocation is covered in Section 3–5.9(c) of the Fundamental Criteria, there is no specific mention of

documenting the methodology.

*Response:* New language has been added to Section 3–5.9(c), under Criteria for Allocations to require adequate written documentation of the allocation formula.

A follow-up comment from the OIG recommended that the OIG be specifically mentioned in the new allocation formula language. *Response:* The OIG has been added to Section 3–5.9(c), under Criteria for Allocations.

An OIG comment recommended the addition of “a sufficient level of fidelity coverage” in Section 3–5.13 (Bonding.) *Response:* In response to the comment Section 3–5.13 has been changed to make specific reference to the fidelity coverage requirements of 45 CFR 1629.1(a).

An OIG comment suggested adding a provision specifying that documents to support competition should be retained and kept with the contract files in Section 3.5.16 (Contracting.) *Response:* In response to this comment language has been added to the competition section, under criteria, to Section 3.5.16, that incorporates the suggestion.

#### **Fraud Prevention (Section 3–6)**

Section 3–6 contains a list of key practices that can help prevent fraud. An LSC OIG comment suggested that there should be an addition to No. 19 to address protection against retaliation for board members and volunteers who report suspected fraud. *Response:* In response to this comment the recommended language has been added to No. 19.

An LSC OIG comment recommended that board members should be reminded that applicable federal and state laws also apply to them. *Response:* In response to this comment new No. 22 has been added incorporating this language.

A comment from the LSC OIG noted that item No. 23 was the only key practice that did not start with a verb. *Response:* New No. 24 has been changed to start with “involve.”

A comment made by an LSC Board member recommended that more specific guidance be given to recipients in the event fraud is discovered. *Response:* In response to this comment language has been added to provide more specific instructions to grantees in the event fraud is discovered. See Section 3–6, No. 26. This same language is found in LSC Grant Assurance No. 15 for 2010 grants, which is signed by both the recipient’s board chair and executive director.

#### **Illustrative Financial Statements and Notes to the Financial Statements (Appendix IA)**

Appendix IA.1 provides a description of illustrative financial statements. A comment from the LSC OIG suggests that the OIG be listed in the first paragraph so that the OIG, as well as LSC, would be able “to make comparison with budgeted amounts as well as accumulate regional or national data for the legal services network.” *Response:* The suggested language has been added to the first paragraph in Appendix IA.1.

#### **Description of Accounting Records—Retention Times for Nonprofit Records (Appendix II)**

Appendix II contains a section on the retention times for nonprofit records. A comment from a nominee to the LSC Board suggested that we add a provision recognizing that state law may provide a longer retention period for certain types of records. *Response:* In response to this comment we have added a new sentence recognizing the possibility that state law may require a longer retention period for particular types of records.

A comment was also received from the LSC OIG recommending that all financial and financial related information be retained for at least five years, given the fact that questioned costs under 45 CFR 1630 can go back five years. *Response:* In response to this comment we have changed the retention period for the mentioned financial and financial related information to seven years, to make this section consistent with 45 CFR 1630 and the Grant Assurances.

#### **Accounting for Property (Appendix IV)**

Appendix IV sets forth procedures for accounting for property, including the capitalization and depreciation of property and equipment. We received comments from JAA & Associates, Hawaii, that the proposed revisions to the illustrations of journal entries for capitalization and depreciation are confusing, incomplete or inaccurate. JAA & Associates also suggested changing the title of Illustration 1.1 under Capitalization from “To record equipment purchased with cash” to “To record equipment purchased with cash or credit.” *Response:* We are also concerned that the proposed revisions in the illustrations in the capitalization and depreciation sections may be confusing. Further, the flow of journal entries can vary somewhat depending on the accounting system used by each LSC grantee. It was determined that while the recommended changes make

sense if journal entries are made in a certain way, there are other valid ways to make entries and the proposed changes could cause confusion. Thus, we have reverted to the 1997 language for the illustrations, which is more easily understandable.

#### **Other Regulatory Financial Requirements (Appendix VI)**

Appendix VI contains provisions on other regulatory financial requirements, including tax reporting. An LSC OIG comment recommended that the language be altered to reflect that form 990 is required to be filed and the failure to file for three consecutive years will automatically result in the loss of a non profit’s tax exempt status.

*Response:* In response to this comment the language has been changed in Appendix VI.1 to specifically mention the mandatory requirement of filing the 990 form and the automatic loss of tax-exempt status for the failure to file a 990 for three consecutive years.

#### **Accounting Procedures and Internal Control Checklist (Appendix VII)**

Appendix VII provides a checklist for a grantee’s internal controls. An LSC OIG comment suggests requiring employees and officers handling assets to be “sufficiently bonded” under Appendix VII A (General.), No. 6. *Response:* In response to this comment Appendix VII A, No. 6 has been changed to add a reference to the bonding requirements found in 45 CFR 1629.

A comment from the LSC OIG questioned whether it was intended in Appendix VII A (General) to have a monthly reporting requirement of a cash flow statement to the finance committee of a recipient’s board of directors. *Response:* Monthly reporting to the finance committee was intended and is consistent with the section 1–7 discussion about role No. 2 of the finance committee. We have changed the second sentence in No. 18 to add “statement of cash on hand,” which is also mentioned in sections 1–7, 3–5.9(b), and Appendix IB.

We also received a comment from a nominee to the LSC Board that Appendix VII B (Personnel and Payroll) should mention that it is a best practice to include both a nondiscrimination policy and a signed statement from every employee that they understand their roles in terms of nondiscrimination. *Response:* In response to this comment a new No. 14 has been added to Appendix VII B incorporating this comment.

An LSC OIG comment suggested that Appendix VII D (Procurement) contain

a requirement that each procurement action, above a reasonable level, be fully documented by maintaining the bids received and the approvals given. This would include written justification for sole source purchases above a certain level. *Response:* In response to this comment a new No. 12 has been added to Appendix D, incorporating the suggestion.

Another LSC OIG comment questioned what "properly executed" means in Appendix VII E (Legal Consultants/Contract Services.) *Response:* In response to this comment we have changed No. 2. in Legal Consultants/Contract Services from "Are contracts written so that the services to be rendered are clearly defined and properly executed?" to the following three sentences: "Are contracts written so that the services to be rendered are clearly defined?"; "Are contracts properly signed by authorized persons?" and "Have all contract terms and modifications been complied with?"

An LSC OIG comment suggested adding to Appendix VII G1 No. 7 that the check should be marked as void or defaced in a manner that would prevent future use of the check. *Response:* In response to this comment Appendix VII G1 No. 7 has been changed to include the recommended language.

An LSC OIG comment pointed out that there was no reference in Appendix VII H (Controls Over Cash Receipts) to cash received from an individual while in the office, as opposed to receiving money through the mail. *Response:* In response to this comment, we have added new Nos. 8–12 in Appendix VII H, to include the questions addressing cash received from an individual while in the office.

The LSC OIG also commented that No. 15 should provide that the client is entitled to a receipt for cash provided and that if a receipt is not provided that the client should see a supervisor.

*Response:* In response to this comment Appendix VII H No. 15 was changed to include the recommended language.

A comment received from the Legal Aid and Defender Association, Detroit, Michigan, questions the segregation of duties guidelines found in Appendix VII, Section J (Segregation of Duties). There is a fear that if duties were assigned to staff outside the accounting department, this staff person may have access to confidential information. *Response:* Appendix VII J contains guidelines for the management of a recipient's financial systems. The objective of Section J is to provide the maximum safeguards possible under the circumstances. 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. In response to this comment and to clarify the inquiry, we have changed the question to: "Are checks, after being signed, controlled and mailed out by an individual who does not have any other payables duties?"

An LSC OIG comment suggested that Appendix VII K (Petty Cash Controls) be changed to add procedures regarding access to and physical control over the petty cash box during and after work hours. *Response:* In response to this comment a new No. 14 has been added to Appendix VII K to include language regarding access to and physical control over the petty cash box during and after work hours.

Dated: July 13, 2010.

**Victor M. Fortuno,**  
President, Legal Services Corporation.

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