



To: Operations and Regulations Committee
From: James J. Sandman, President
Re: Management Recommendations on
Rulemaking Options—TIG Third-Party Contracting
Date: April 4, 2012

SUMMARY

The Office of Legal Affairs (OLA) has provided the Committee with a Rulemaking Options Paper (ROP) addressing issues involving third-party contracting by LSC recipients using funds from LSC Technology Initiative Grants (TIGs). Management instructed OLA to provide the ROP as part of Management's response to audit AU-11-01, in which the LSC Office of Inspector General (OIG) reviewed LSC's operation of the TIG program. The ROP explains the two contracting issues raised by the OIG and provides OLA's recommendation regarding the appropriate rulemaking procedures. This memorandum offers Management's recommendation regarding these options.

Recommendation 29 of AU-11-01 states:

The President of LSC should: To the extent that the subgrant rule does not adequately account for the unique features of TIG grants, initiate a process to amend LSC regulations to account for these features and provide for workable oversight of TIG funds paid to third parties.

This recommendation was based in part on the OIGs' concern that third-party payments made by grant recipients using TIG funds were not subject to sufficient financial oversight. In response, Management has already taken a number of steps to enhance the oversight of third-party payments in the TIG program. Those steps are described below. Management does not believe that rulemaking is necessary to provide tools for improving financial oversight of third-party payments. Management can address this issue adequately using its existing authority under the LSC cost standards rule, 45 C.F.R. Part 1630.

The OIG also concluded that certain business-service contracting under some TIGs constituted Part 1627 subgrants and Part 1610 transfers because the contracting involved the primary purpose of the TIG itself and/or used almost all of the funds granted in the TIG. OLA and Management disagree with the OIG's interpretation of these rules. OLA's interpretation, and LSC's longstanding application of the rules, is that whether a third-party contract for services constitutes a subgrant or a transfer depends on the extent to which the services contracted for are legal services, not on the type of LSC grant that the funds to pay for the services are drawn from. To resolve Management's disagreement with the OIG over the interpretation of the existing rules, Management recommends that the Board commence rulemaking to further clarify the rules consistent with LSC's longstanding interpretation and application of them.

NON-SUBGRANT, THIRD PARTY CONTRACTING

As described in the ROP, the OIG recommended rulemaking to “provide for workable oversight of TIG funds paid to third parties.” Recommendations 5 and 34 in AU-11-01 addressed financial oversight of third-party contracting in TIG grants. In response, LSC Management has adopted new procurement requirements for TIGs involving expenditures of over \$3,500 for service contracts, including competition and documentation requirements. These changes have been added to the TIG Procedures Manual and to the draft 2012 TIG Grant Assurances. The OIG has determined that these actions are sufficient to close these two recommendations.

The new TIG contracting requirements have been adopted under LSC’s authority to implement the cost-standards requirements of 45 C.F.R. Part 1630, which require LSC recipients to follow cost standards for all expenditures of LSC funds, including contracting. Part 1630 does not set out specific third-party contracting requirements, but generally provides that all expenditures must be reasonable and necessary for carrying out LSC grant(s) consistent with ordinary business practices. 45 C.F.R. § 1630.3(b). All expenditures of LSC funds, regardless of the amount, must be documented for Part 1630 purposes and meet the Part 1630 requirements regarding reasonable costs following “generally accepted sound business practices, Federal and State laws and regulations, and the terms and conditions of the grant or contract” 45 C.F.R. § 1630.3(b)(2). When an LSC grantee provides LSC funds to a third party, it must follow the Part 1630 requirements. LSC Management has discretion under the regulation to determine whether the expense is sufficiently documented and justified.

The 2012 TIGs will be awarded toward the end of this year. Through the next year, LSC will be able to evaluate how well the new TIG contracting requirements operate. Many, if not all, LSC recipients have their own contracting procedures, and many are already subject to federal contracting requirements for grants from agencies such as the Department of Justice (under Violence Against Women Act grants). If the current TIG contracting requirements prove ineffective or unworkable, then Management can revise them. Management believes that incorporating special TIG contracting requirements into the regulations is unnecessary and would reduce this important discretion.

PRIMARY-PURPOSE, OR PASS-THROUGH, THIRD-PARTY CONTRACTING

As described in the ROP, the OIG disagrees with OLA and Management regarding the application of the subgrant and transfer rules to TIGs that are primarily for business or technology services. In some of these TIGs, one contractor handles almost all of the work, and in others a contractor manages the work. These are activities that would not constitute subgrants or transfers if they were funded out of a basic field grant or a larger, more general purpose, TIG. The ROP explains OLA’s legal analysis. AU-11-01 specifically notes that the OIG believes the rule as written does not necessary fit well with the operation of the TIG program. The OIG’s primary concern appears to be ensuring that all third-party contracts are categorized properly and that there is sufficient financial oversight for all of them, regardless of categorization.

Management believes that TIG grant recipients should have the benefit of uniform guidance from LSC on the application of the subgrant and transfer rules. Disagreements between OIG and Management on the interpretation of LSC's regulations are not helpful to the field. Management therefore recommends that the Board initiate a notice and comment rulemaking process to amend Parts 1610 and 1627. Management believes the amendments should clearly reflect LSC's longstanding reading of these rules – that is, that both rules are designed to address legal services activities. Both rules explicitly state that they do not cover non-programmatic activities and provide examples, including payments to vendors of goods or services made in the normal course of business. The preapproval and auditing requirements for subgrants reflect a desire by LSC to maintain the kind of control and accountability that it has for primary grants. When LSC adopted the transfer rule, it based the transfer definition on the subgrant definition. The transfer rule subjects the transferee to all of LSC's substantive restrictions on legal services activities, including the 1996 restrictions that reach the use of non-LSC funds. These restrictions involve *legal services* activities (such as class actions, representation of aliens, and lobbying) and *legal aid program operations* (such as program priorities and timekeeping for cases and matters). As with the subgrant rule, the transfer rule does not extend those restrictions to non-programmatic procurement of goods or services. Management does not believe it would be prudent grant management to extend these types of restrictions and requirements to third-party vendors that provide business services and technology services as part of TIGs. These LSC restrictions are meant to apply to entities that receive LSC funds for the provision of legal services under the LSC Act.

Management also recommends this option because of its fitness in other LSC grantmaking contexts. Currently LSC provides emergency and special needs grants that are often for specific non-programmatic expenses. For example, LSC makes some emergency grants for the replacement of offices, equipment, and infrastructure damaged or destroyed in natural disasters. A recipient might pay out all of an emergency grant to one or more third-party contractors for goods or services that are unrelated to the provision of legal services. Under the OIG's analysis, those third parties would become Part 1627 subgrantees and Part 1610 transferees, and they would be subject to LSC's restrictions. Under OLA's analysis, those third-party contracts would be analyzed in the same manner as if they had been paid for out of a basic field grant. Management believes that these types of grants would be unnecessarily hampered by application of the subgrant and transfer rules and that those rules were not intended to reach these situations. It is unlikely that the vendors involved would agree to the subgrant and transfer restrictions, especially as to their non-LSC funds.

Under the current approach, LSC treats all third-party contracts consistently under the rules, regardless of what type of grant the LSC funds come from. This provides important clarity for recipient compliance and LSC oversight. Management does not recommend an oversight system in which the same activities would be a subgrant and a transfer under some types of grants but not under others.

CONCLUSION

Management believes that the underlying concerns for Recommendation 29 in AU-11-01 are best addressed through the combination of Management's new TIG requirements for third-party contracting and revision of the rules to reflect LSC's longstanding application of them. This approach would maintain Management's flexibility regarding oversight of TIG funds paid to third parties. It would also resolve the disagreement regarding the scope of both rules.