LSC

Legal Services Corporation
America's Partner For Equal Justice

April 14, 2014

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Dear Ms. Bentz:

I am writing in response to the March 13, 2014 appeal by Inland Counties Legal Services (Inland Counties) of the Legal Services Corporation's (LSC) Management Decision to disallow $252,069.33 in costs incurred by Inland Counties and paid for with LSC funds during the years 2009 and 2010.

I have carefully reviewed the record and have decided to affirm the disallowance of $252,069.33. I explain the reasons for my decision below.

Background

In 2011, the LSC Office of Inspector General (OIG) conducted an audit of Inland Counties' internal controls. As a result of its audit, OIG questioned $1,384,670 in stipends and benefits paid to Inland Counties' staff for the years 2006-2010 as not reasonable and necessary for the performance of the LSC grant. *See* 45 C.F.R. § 1630.2. Specifically, OIG found that the costs did "not reflect the actions a prudent person would take in the circumstances." 45 C.F.R. § 1630.2(g)(3). OIG referred the questioned costs to LSC's Office of Compliance and Enforcement (OCE) for further action.

On September 30, 2013, OCE sent Inland Counties a Notice of Questioned Costs ("Notice") questioning $252,069.33 of the $1,384,670 referral. This amount related to the stipends and benefits paid to staff for grant years 2009 and 2010, the only years for which OCE could disallow costs. *See* 45 C.F.R. §1630.7(b) (barring LSC from disallowing costs where the costs were incurred more than five years before LSC determines that there is a basis for questioning the costs). OCE asserted that because Inland Counties used LSC funds to pay stipends and benefits to all staff, regardless of whether they worked on LSC grant-related work, the allocation of costs was inconsistent with 45 C.F.R. § 1630.3(c) and was therefore unreasonable. OCE based its assertion on the fact that stipends and benefits are considered salary expenses, which are direct costs allocable to the grant for which they were incurred, and only stipends and benefits paid to employees who performed work related to Inland Counties' LSC grant (as opposed to Inland

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Counties' other grants) could be allocated to the LSC grant. *See* 62 Fed. Reg. 68219, 68222 (Dec. 31, 1997); 45 C.F.R. § 1630.3(d).

On November 2, 2013, Inland Counties responded to the Notice, contending that its good-faith business decision to pay all of the stipends and benefits from its LSC fund balance was necessary to compensate its staff, who were consistently paid below-market salaries. Inland Counties conceded that the stipends and benefits paid to individuals who worked on non-LSC activities were unallowable. Inland Counties argued, however, that stipends and benefits paid to individuals who worked on non-LSC activities that were eligible to be, but were not, charged to the LSC grant were permissible and properly allocable to the LSC grant.

In subsequent communications, OCE asked Inland Counties to explain why stipends and benefits paid to support staff and program administration were not allocated on an equitable basis as indirect costs or, alternatively, across its funding sources in the same proportions as salaries and wages had been allocated. *See* 45 C.F.R. § 1630.3(f) (allowing costs that cannot reasonably be allocated to one grant to be treated as indirect costs and allocated across grants on an equitable basis). Inland Counties responded that because nearly all staff were supported by LSC grant funds or engaged in LSC-eligible activities, Inland Counties believed it was appropriate to allocate all of the payments to its LSC grant. In addition, Inland Counties stated that two of its other grants limited the amount that could be used for administrative costs, such as stipends and benefits, so it made a business decision to charge the stipends and benefits to its LSC grant, which is not similarly restricted.

On January 29, 2014, LSC's Vice President for Grants Management issued a final Management Decision ("Decision") sustaining the disallowance of $252,069.33 in full. The Decision did not accept Inland Counties' argument that the portion of the stipends and benefits attributable to LSC-permissible activities was properly charged to the LSC grant, finding that Inland Counties' responses failed to support its claim by a preponderance of the evidence. Relying on 45 C.F.R. § 1630.3(c)(2), the Decision concluded that because the payments were charged to the LSC grant without regard to the proportional benefit each employee provided to the LSC grant, they were unreasonable. This appeal followed.

Analysis

Inland Counties does not contest LSC's determination that the stipends and benefits at issue were not properly allocated. In its appeal of the Management Decision, Inland Counties "accepts LSC's judgment that the funds associated with the stipends were not allocated correctly and agrees that recoupment of LSC funds is warranted under the circumstances." Inland Counties now contends only that the amounts of the disallowed costs should be reduced. I have nevertheless reviewed and considered all aspects of the Management Decision and have concluded that the Decision was clearly correct on the merits.

Inland Counties advances two arguments for reducing the amount of the disallowed costs.

First, Inland Counties argues that LSC should use the information from Inland Counties' audited financial statements to calculate the disallowed amount, rather than relying on the financial information that Inland Counties reported to LSC at the end of the 2009 and 2010 grant years.

Second, Inland Counties argues that LSC should adopt one of two proposed reductions in the amount of disallowed costs to enable Inland Counties to meet its programmatic goals for 2014. The first proposal is to offset the questioned costs by the amount Inland Counties intends to spend on hiring two attorneys and on an upgrade to its information technology infrastructure. The second proposal is to recover only those costs associated with stipends and benefits paid to employees whose positions were entirely funded by non-LSC grants.

A. Financial Information Used to Calculate the Disallowed Costs

Inland Counties argues that LSC should use its audited financial statements, rather than the unaudited Grant Activity Reports it submitted to LSC, to calculate the disallowed costs. Inland Counties asserts that the audited financial statements show that LSC funds represented 68.82% of Inland Counties' total funding in 2009 and 72.63% of Inland Counties' total funding in 2010. If the figures Inland Counties proposes were used to calculate the disallowed costs, the questioned amount would decrease from $252,069.33 to $224,644.

Inland Counties' argument is flawed. The figures that Inland Counties uses to support its argument do not reflect its total funding for calendar years 2009 and 2010; those figures exclude prior year carryover funds for its LSC and non-LSC grants in its calculations, although the carryover funds are listed as assets on Inland Counties' financial statements for those years. As stated in the Notice of Questioned Costs, OCE determined LSC's contribution to Inland Counties' total funding for calendar years 2009 and 2010 by dividing the total funding Inland Counties received from all sources by the total of LSC funds available. OCE calculated the total of Inland Counties' funding *from all sources* in each year by adding the amount of grant funds awarded by LSC and other entities in each year, carryover funds from all sources from the prior year, and other income, which included interest and program income. OCE used the same methodology — adding the LSC basic field grant, prior year LSC carryover funds, and other income derived from the LSC grant — to calculate the total amount of *LSC funds* available to Inland Counties for each year.

Using these calculations, OCE determined that LSC funding constituted 68% ($4,975,700) of Inland Counties' total funding ($7,264,340) in 2009 and 66.6% ($5,216,635) of Inland Counties' total funding ($7,837,577) in 2010. When the carryover funds are included in the calculations based on the audited financial statements, LSC funds represent 68% and 66.6% of Inland Counties' total funding for grant years 2009 and 2010, respectively — exactly the percentages LSC used to calculate the costs at issue. I have concluded that carryover funds should be included in the calculations. I have therefore determined that the amount questioned by OCE, $252,069.33, is correct, regardless of which financial reports are used.

B. Inland Counties' Alternative Proposed Resolutions

I recognize that my upholding the disallowance of $252,069.33 will affect Inland Counties' ability to add staff and make improvements in technology that would benefit clients. But LSC's recoupment of any improper expenditure by a grant recipient will almost always have adverse consequences for the recipient's ability to serve its clients. I do not think that can be the test of whether LSC should recover questioned costs. LSC has a responsibility to Congress and to taxpayers to ensure that funds appropriated to LSC are used properly. I believe it is in the best interest of the clients of *all* of the programs LSC funds for LSC to discharge that responsibility rigorously. Our failure to do so could jeopardize the funding on which hundreds of thousands of people across the country depend for legal services.

In addition, I do not believe that Inland Counties' proposal that LSC recover only those costs associated with stipends and benefits paid to employees whose salaries were supported entirely with non-LSC funds is appropriate. The Management Decision's allocation methodology was clearly correct under LSC's regulations and was appropriate as a matter of prudent grants management. The stipends and benefits were properly allocated to the LSC grants only to the extent that the individuals receiving them performed work that was charged to the LSC grant. Inland Counties could not charge LSC grants for stipends and benefits awarded for non-LSC work.

I want to stress that I greatly appreciate the work that Inland Counties' staff do every day to serve their clients. I respect, admire, and am grateful for the sacrifices they make in the pursuit of equal justice for all. I have read every one of the letters that staff submitted with Inland Counties' appeal; each tells a story of strong personal commitment to providing access to justice without regard to a client's economic status. My decision should not be interpreted as a determination that Inland Counties' staff do not deserve to be rewarded for their efforts. Rather, my decision reflects my conclusion that LSC funds were used in an inappropriate manner and my conviction that LSC's enforcement of its fiscal requirements is necessary and beneficial to the accomplishment of our mission.

Conclusion

In accordance with 45 C.F.R. § 1630, I am disallowing $252,069.33 in expenditures of LSC funds made by Inland Counties during calendar years 2009 and 2010. This amount will be recovered by LSC through monthly deductions of $36,009.90 from Inland Counties' grant payment beginning in May 2014 and continuing through the final grant payment for 2014.

Sincerely yours,

James J. Sandman
President