NLADA
National Legal Aid & Defender Association

Sent by email to: financialguide@lsc.gov

October 15, 2020

Mark Freedman
Senior Associate General Counsel
Legal Services Corporation
3333 K Street NW
Washington, DC 20007

RE: **Comments Concerning Legal Services Corporation Financial Guide;** 85 Fed. Reg. 40688 (July 7, 2020)

Dear Attorney Freedman,

This letter is submitted in response to Legal Services Corporation's (LSC) request for comments on the proposed revisions to "LSC's Accounting Guide for LSC Recipients, 2010 Edition." The revisions are in the form of an entirely new document, titled "Legal Services Corporation Financial Guide." These comments are submitted on behalf of the National Legal Aid & Defender Association (NLADA) and its members. These comments are not simply a reflection of NLADA's knowledge or opinions, but the knowledge, experience, and insight of our program members, which include the vast majority of LSC grantees. In preparing these comments, NLADA consulted with over a dozen CFOs of LSC grantees in addition to the program directors and other individuals who sit on our regulations committee. These experts represent a diverse group of programs in terms of location, size, sophistication, and other factors. Over a number of virtual meetings, NLADA received valuable input throughout this process about how differently situated grantees craft fiscal policy and balance the complex requirements from a host of different funders.

NLADA applauds LSC for its work on revising/replacing the ten-year-old LSC Accounting Guide as it seeks to create a guide that is up to date, comprehensive, and able to provide clarity to grantees. We also wish to thank LSC for the opportunity to comment and share the input we received from our members representing LSC grantees from across the country.

We present our comments here by first addressing our general concerns with the guide, and then addressing specific sections or terms.

I. **COMMENTS ON THE LSC FINANCIAL GUIDE DRAFT IN GENERAL**

The new LSC Financial Guide draft improves upon the LSC Accounting Guide, 2010 Edition in many ways. It provides needed updates, improves clarity in many sections, and gives a much more comprehensive understanding of the important issues grantees need to consider when crafting a sound fiscal policy.

Nevertheless, NLADA and its members have significant concerns about the overall approach to this guide. Our larger concerns center on (1) the guide's failure to acknowledge and account for the unique and diverse on–the-ground realities faced by LSC grantees and (2) questions about what is the appropriate purpose of such a guide.

A. THE GUIDE FAILS TO EXPLICITLY OR EVEN IMPLICITLY RECOGNIZE THE DIVERSE NEEDS, LEVEL OF RESOURCES, AND CHALLENGES OF LSC GRANTEES ACROSS THE COUNTRY

Almost all of the concerns of NLADA and our members stem from one larger issue: the proposed draft of this guide fails to take into account the diverse needs of LSC grantees, the challenges they face, and the unique solutions they have crafted to navigate a complex fiscal landscape.

LSC grantees operate in areas that are classified as urban, rural remote, and everywhere in between. There are grantees with budgets over $50 million with staffs that number in the hundreds. Others are operating with a budget of less than $1 million and fewer than 10 FTE. For some programs, LSC funds represent over 80 percent of their budget while other programs' budgets consist of over 80 percent non-LSC funds. Some programs might be allocating across only 3 or 4 funding sources while others may be doing so over many dozens. For many programs, LSC is a minority funder, and the accounting systems already in place in these programs address the existing challenge of complying not just with current LSC requirements, but the requirements of many other funders, including other federal entities, state and local governments, and private funders. This financial guide never acknowledges just how differently situated LSC grantees are from one other or how different accounting methods and practices might be more or less appropriate (or even possible) in different contexts. Appropriate internal controls might look different for a staff of 9 than it does for a staff of 500. Allocation methods for a grantee with 4 funding sources might not be practical for a grantee who is dealing with 20 times as many funders or more.

NLADA has no doubt that the requirements listed in this financial guide have been carefully considered and developed with a sound understanding of accounting principles and general fiscal policy. We are concerned, however, that they were not crafted with a careful consideration of the on-the-ground realities of legal services generally and the individual circumstances of the diverse group of organizations that are LSC grantees specifically.

Much of this guide could be improved by simply changing "must" style requirements to an explanation of LSC-recognized best practices. In that event, programs who deviate from the practices can explain why that practice was inappropriate or not possible for their program, explain what, if any, substantively similar practices they have put in place, and explain how they are nevertheless able to demonstrate compliance with existing LSC requirements.

There are a myriad of reasons why it is impractical to require each and every grantee to adopt the exact same accounting practices and methods. Perhaps a program lacks resources or personnel to institute many of these new regulatory-style rules. Maybe certain accounting processes do not make sense for a grantee because of how it has to handle funds from a number of other sources, sources which may have their own requirements. Or perhaps a grantee has, over the years, found an effective and efficient way to manage non-LSC federal, state, local, and private funding sources while still complying with all existing LSC requirements. The current draft does not acknowledge these scenarios or account for them. Programs should have the discretion and flexibility to choose among different accounting methods, provided they can explain their reasoning and reliably demonstrate they are in full compliance with existing LSC requirements.

B. <u>THE CURRENT LSC FINANCIAL GUIDE DRAFT GOES TOO FAR IN CREATING NEW AND OVERBEARING REGULATORY STYLE REQUIREMENTS</u>

LSC grantees are subject to a number of LSC specific requirements. These are listed and explained in the LSC Act, the 1996 appropriations, the LSC regulations located at 45 C.F.R. 1600 – 1644, LSC's performance criteria, and LSC's Advisory Opinions and Program Letters. A financial guide's central purpose should be to assist programs in how they might best comply with those requirements while providing guidance on how they might implement recognized best practices and achieve desired outcomes, not just in terms of LSC requirements but also in terms of sound fiscal policy and accounting.

The Corporation's new draft extends far beyond these parameters. In its current form, it is less of a guide and more of an expansive regulation, creating new prohibitions and compulsory processes that are not based in any existing LSC-related legislation or regulation. As the draft states in Section 1.1, "The Guide contains several new requirements that grantees <u>**must**</u> adopt."[1] This statement reflects a particular approach that reaches beyond providing guidance on how to achieve outcomes in compliance with existing regulations to mandating the implementation of practices that are very specific, often burdensome, and sometimes impractical. This is an approach with which we strongly disagree.

Furthermore, the quoted declaration in Section 1.1 even understates things. In fact, the guide contains the word "must" 217 times and "shall" another six times. Such a high number is not in and of itself a sign that the guide goes beyond an appropriate purpose, but a careful look at these instances reveals a guide that overreaches by a significant margin. It does not merely explain which fiscal outcomes grantees must be able to demonstrate nor does it simply summarize the existing requirements with which they must comply. Instead, this guide mandates exactly how grantees must achieve those outcomes while creating brand new requirements and prohibitions that would be made applicable to every LSC grantee. It is a guide that unilaterally creates new rules without having to enshrine such rules in code or go through the formal rulemaking process.

[1] LSC Financial Guide DRAFT, § 1.1, Page 1 (emphasis added).

In the 2010 accounting guide, there are also many instances of the words "must" (87) and "shall," (59). The critical difference is not in the number of times the words are used, but in how they are used. In the 2010 edition, the words are more often used to convey generalized obligations to act with due diligence or as a restatement of existing requirements. Examples include:

- The recipient's accounting records must accommodate the accumulating and supporting of costs by grant and contract. An LSC recipient's accounting records maintained on a fund accounting basis should provide an adequate basis upon which to prepare its annual financial statements.[2]

- Each recipient must have adequately trained, competent accounting personnel to properly document, record, account for, and report financial transactions.[3]

- LSC requires that property purchased with LSC funds must be disposed of in accordance with LSC's Property Acquisition and Management Manual or its duly adopted successor.[4]

- A record documenting charges of gross payroll expenses to accounts/funds/cost centers shall be maintained.[5]

- The allocation of a cost to an activity must demonstrate the total cost of the activity that a funding source is financing.

All of these statements are generalized requirements that already exist and/or are focused on the overall result that must be achieved. They do not make new specific prohibitions nor do they mandate the exact process a program must use. Compare the above with this example from the draft of the new Financial Guide:

> Recipients **must** maintain a labor cost distribution report within their payroll system that details hours worked, wages earned, and benefits accrued by a recipient's employees. The labor cost distribution report **must** include information about what organizational funds are used to pay for that labor. Inadequate labor cost distribution records may result in the improper allocation of payroll costs to funding sources. Therefore, recipients **must** reconcile the timekeeping reports that are generated from their case management system with the labor cost distribution reports that are generated from their payroll system on an annual basis, at a minimum.[6]

Although NLADA agrees that programs should have appropriate accounting methods to ensure that they do not have "improper allocation of payroll costs to funding sources," the level of specificity in the exact processes that this guide imposes upon every grantee is inappropriate.

[2] LSC Accounting Guide, 2010 Edition, Page 20.
[3] LSC Accounting Guide, 2010 Edition, Page 23.
[4] LSC Accounting Guide, 2010 Edition, Page 14.
[5] LSC Accounting Guide, 2010 Edition, Page 31.
[6] LSC Financial Guide Draft, § 2.2.3.c, Page 8 (emphasis added).

Rather than simply require programs to have appropriate accounting procedures to ensure proper allocation, the guide wants to institute a one-size-fits-all approach to all grantees on exactly how they should go about doing so. This kind of top-down requirement creates a micromanaging of accounting methods that would be inappropriate in a regulation, let alone a guide.

Beyond that, the guide also includes rules about the frequency with which programs conduct closings, new prohibitions on LSC funds, and new requirements on topics that are already regulated by the C.F.R. If this guide were to take effect, these new requirements would render the majority of programs out of compliance immediately. This includes a number of programs with a sophisticated fiscal staff and robust accounting practices, programs that LSC would likely consider high performing. Although we appreciate the desire to increase clarity to grantees, we do not support an increase in clarity that comes at the cost of flexibility, practicality, autonomy, and all other considerations.

II. COMMENTS ON SPECIFIC SECTIONS AND WORDING IN THE LSC FINANCIAL GUIDE DRAFT IN GENERAL

A. THE USE OF THE TERM "SUPERVISOR" IN THIS GUIDE IS DONE WITHOUT ALLOWING REASONABLE ALTERNATIVES OR APPROPRIATE FLEXIBILITY

In a number of sections, the guide requires an employee's supervisor to take certain actions. In most instances, this is unlikely to pose problems. However, in time-sensitive or unique situations, an employee's direct supervisor may not be available to approve a timesheet[7] or reimbursement expenses.[8] We suggest a minor change in wording so that "supervisor(s)" would be replaced with "supervisor(s) or other appropriate management staff." Such a small change avoids a compliance issue simply because a supervisor is on vacation or out on other leave when timesheets or expenses must be approved in a timely manner.

B. THE REQUIREMENTS IN SECTION 2.2.3 ON RECONCILIATION ARE OVERLY RIGID AND WOULD REQUIRE SOME PROGRAMS TO COMPLETELY CHANGE OTHERWISE ACCEPTABLE ACCOUNTING SYSTEMS.

Section 2.2.3 discusses reconciliation, specifically reconciliation between labor costs and timekeeping reports. The section notes that "Inadequate labor cost distribution records may result in the improper allocation of payroll costs to funding sources." That may be true, depending on how a program allocates costs and handles timekeeping, but there are existing requirements that grantees properly allocate funding sources, and the appropriate role for the guide would be to recommend one or more ways to ensure proper allocation, not to mandate a specific practice. Section 2.2.3 would require that all grantees approach this by:

- "Maintaining a labor cost distribution report within their payroll system"
    - "That details hours worked, wages earned, and benefits accrued by a recipient's employees"

[7] <u>See</u> LSC Financial Guide Draft, § 2.2, Page 7.
[8] <u>See</u> LSC Financial Guide Draft, § 3.8.6.c, Page 43.

- Which "must include information about what organizational funds are used to pay for that labor."
- And grantees would then be required to "reconcile timekeeping reports that are generated from their case management system" with these labor cost distribution reports.[9]

A number of grantees with whom NLADA consulted expressed frustration that such a system would be onerous and impractical, and, in the case of some programs, it would require them to switch to an entirely different accounting method. Requiring programs to do so is burdensome and expands well beyond the administration of LSC funds, affecting how they administer and account for many other sources of funding.

It is entirely appropriate for LSC to require programs to correctly allocate costs. This is required under 45 C.F.R. § 1630, and it is necessary to ensure that LSC funds are not used for restricted activity. It is not appropriate for LSC to demand programs use a specific accounting method and require exactly how they must go about reconciling timekeeping, payroll, and labor reports to achieve proper allocation.

C. <u>REQUIRING BOARD MEMBERS TO APPROVE THE TIMESHEETS OF THE EXECUTIVE DIRECTOR INAPPROPRIATELY INVOLVES THE BOARD IN THE DAY-TO-DAY OPERATIONS OF THE ORGANIZATION</u>

Section 2.5.1a outlines the responsibilities of the financial oversight committee. It notes, among other things, that this board committee must "review and approve the Executive Director's expenses, timesheets, and compensation."[10] First, it is important to emphasize that board members of legal services organizations are not compensated and are already taking on a great number of responsibilities, in addition to their overall fiduciary responsibility. Asking board members to go through and review when an executive director arrives at the office in the morning, how late they stay, or when they choose to take their vacation days is not appropriate or practical, and it may even make it more difficult to recruit and retain quality board members. Beyond that, it simply is not good practice. LSC's own performance criteria notes that best practices are that:

> The board is involved in major policy decisions, aware of issues in and performance of the program, while leaving day-to-day management of program operations to program management personnel.[11]

Asking the board to review a director's timesheets is perhaps the quintessential example of involving them in the literal day-to-day operation of program management. Directors should be judged by boards on the overall direction and results of the program, and boards should not get bogged down in the minutiae of approving timesheets.

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[9] LSC Financial Guide Draft, § 2.2.3.c, Page 8.
[10] LSC Financial Guide Draft, § 2.5.1.a, Page 12.
[11] LSC Performance Criteria Area 4: Effectiveness of governance, leadership and administration, Criterion 1: Board Governance, "

D. <u>ADDING NEW REQUIREMENTS TO 45 C.F.R. 1629 GOES BEYOND THE PROPER SCOPE OF A FINANCIAL GUIDE</u>

In Section 2.5.4, this draft requires that:

> The Board of Directors of each recipient must ratify at each policy renewal that fidelity bond or similar insurance coverage is held for all employees, officers, directors, agents, volunteers, and third-party contractors who handle LSC funds.[12]

There is already a regulation governing fidelity bonds and similar insurance. In 45 C.F.R. 1629, LSC has listed a number of requirements for the fidelity bond coverage that all LSC grantees must carry, including who must be covered, what the minimum amount must be, and whether or not LSC funds may be used to pay for the coverage.

It may be a best practice to have the board acknowledge appropriate insurance at annual board meetings or even to ratify the insurance when it is renewed. Still, it is inappropriate for LSC to use the Financial Guide to make this a "must" and essentially issue new requirements on topics already fully covered by regulations. At most, the guide should list this issue as a best practice or suggestion, not a requirement.

E. <u>REQUIRING ALL RECIPIENTS TO POST THEIR GENERAL LEDGER MONTHLY IS A ONE-SIZE-FITS-ALL APPROACH THAT OVER-REGULATES BY MANDATING NOT ONLY WHAT GRANTEES MUST ACHIEVE, BUT HOW THEY MUST GO ABOUT DOING SO.</u>

This draft of the financial guide requires, in Section 2.6.1, all recipients to post their general ledger every month. It in fact goes further, noting that when they do so, grantees must complete a "detailed month-end close schedule" that <u>**must**</u>:

- "identif[y] due dates and responsible individuals"
- "include preparing a trial balance, statement of financial position, and statement of activities" and
- "reconcile [any out-of-balance conditions] with evidence or review."[13]

Many LSC grantees already post a general ledger monthly, but others do not, and it is not simply an issue of resources. Programs with different funding sources, which operate with different disbursement schedules, may find that posting a general ledger and doing a detailed monthly closing of the books is not simply resource-intensive, but actually counterproductive. They may have to "re-open" to reallocate, recalculate, and redo such closings on a regular basis and possibly every time. As with issues related to labor costs and timekeeping reconciliation, NLADA does not object to a guide that provides guidance to grantees on best practices and alternatives on how to achieve required results. We do strenuously object to a micromanaging of exactly how each grantee must get to those results.

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[12] LSC Financial Guide Draft, § 2.5.4, Page 17.
[13] LSC Financial Guide Draft, § 2.6.1., Page 19.

F. NOT EVERY GRANTEE HAS SUFFICIENT STAFF TO MAKE CONDITIONS SUCH AS THOSE IN SECTION 3.2.2.C A REASONABLE REQUIREMENT.

Section 3.2.2.c requires not only that grantees perform monthly reconciliations, but that such reconciliations are done by someone who:

- "does not initiate or transmit electronic transactions"
- "has no access to cash"
- "is not a check signer"
- "and has no bookkeeping duties"[14]

As stated in the general concerns, some grantees have a staff of 9. That is not the staff of their fiscal department, but of the entire program. The idea that the smallest of LSC grantees or even the mid-sized grantees have the appropriate staff to, on a monthly basis, find someone who meets all the above criteria to competently perform a monthly reconciliation is not realistic. Like other topics in this guide, this issue can be easily addressed by suggesting that, ideally, an individual who performs reconciliations would meet all or most of the above criteria, but that such criteria are not requirements.

G. THE FINANCIAL GUIDE'S PROHIBITION ON MEALS AND REFRESHMENTS IS UNNECESSARILY DRACONIAN AND DOES NOT REPRESENT BEST PRACTICES

LSC creates a brand new prohibition in Section 3.8.3.a of this guide when it writes:

> LSC prohibits using LSC funds for meals and refreshments, except for courtesy coffee, tea, and similar beverages and minor refreshments as part of employee recognition or major substantive work events, or when they are necessary costs of conducting trainings, fundraising events and conferences.[15]

Implementing this restriction on LSC funds would make it harder for LSC grantees to participate in industry standard practices. These practices include, but are not limited to:

- offering employees meals during lunchtime trainings;
- providing food for board members when meetings occur during traditional meal times;
- paying for meals when meeting with potential donors; and
- providing meals to staff when they have to conduct intra-day travel or work extended hours.

These are not just "extras," but basic professional courtesies in the legal profession. It is not a best practice to deny these basics to staff or board members. Legal services organizations already struggle with employee recruitment and retention as they confront low compensation and difficult caseloads. Banning a supervisor from using LSC funds to purchase a staff attorney a

[14] LSC Financial Guide Draft, § 3.2.2.c, Page 25.
[15] LSC Financial Guide Draft, § 3.8.3.a, Page 41.

takeout meal when they have to stay late into the night to work on a challenging case or prohibiting a director from providing a few slices of pizza when staff have to gather over their lunch hour is the wrong approach. Furthermore, attracting volunteers for the critical role of board governance will not be made easier if they are nickeled and dimed and must bring their own food to meetings.

The LSC regulations already require that all purchases must be reasonable and necessary. Purchases of food that do not meet that requirement can be challenged and disallowed. Reasonable and necessary might be harder to define, but it is nevertheless the more appropriate standard.

NLADA concedes that there are some programs which have sufficient non-LSC funds with which they can purchase food if such a rule were to be created by this financial guide, but there are others who have very limited non-LSC funds. Beyond that, pointing out that non-LSC funds might be available misses the larger point; this prohibition is not sound policy for legal services organizations and, accordingly, LSC should not have such a restriction on their funds.

III. CONCLUSION

Despite our listed concerns, NLADA wants to emphasize how grateful we are for the Corporation's effort to develop a comprehensive guide. It is apparent there was an intent to provide clear guidelines for all LSC grantees, and we applaud that goal. Our concerns stem from a worry that, in some instances, what might be gained in clarity could cause significant losses in flexibility, program autonomy, practicality, and ideal operations. It would certainly make things more clear to grantees were LSC to prohibit the purchase of food wholesale instead of allowing meals only when they are "reasonable," but simply because a rule is easier to interpret does not necessarily make it a more sound policy.

In reviewing this guide, we urge the Corporation to reconsider the imposition of so many new and rigid requirements on practices, and to instead focus on the necessary outcomes and provide guidance to grantees on how to navigate the already expansive existing requirements. Accounting experts employ a variety of methods depending on the unique characteristics of their organizations. We urge LSC to think about the diverse group of grantees it serves and how best or even appropriate fiscal policy might differ among the varying programs. Statements of these best practices and effective measures are much more appropriate and can provide the guidance needed by such a diverse group of grantees managing complex fiscal landscape.

Sincerely,

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