

OLA External Opinion # EX-2003-1008

May 8, 2003

Page 2

The four-page proposal is attached and incorporated into this opinion letter. In brief, the proposal is from LSNY, its s

a payment of LSC funds to support, in whole or part, a restricted activity conducted by another entity, or a payment to another entity to cover overhead, in whole or in part, relating to a restricted activity. A recipient will be considered to be subsidizing the restricted activities of another organization if it provides the use of its LSC-funded resources to the organization without receiving a “fair-market price” for such use.

62 Fed. Reg. 27698 (May 21, 1997) (preamble to final rule).

Finally, the organizations must be physically and financially separate. 45 CFR §1610.8(a)(3). Physical and financial separation is characterized by a variety of indicia, including but not limited to:

- (1) the existence of separate personnel;
- (2) the existence of separate accounting records;
- (3) the degree of separation from facilities in which restricted activities occur, and the extent of such restricted activities; and
- (4) the extent to which signs and other forms of identification which distinguish the recipient from the other organization are present.

Physical and financial separation is the most nuanced and complex of the three factors that the regulation requires be met. Whether physical and financial separation exists is determined on a case-by-case basis, based on the totality of the circumstances. Individual factors present in one situation might be acceptable in the context of the overall relationship between the entities, although they might be unacceptable in another situation in which other factors weigh more heavily against a finding of sufficient separation. However, in all situations the separation between the organizations must be clear to clients, courts, agencies and others with whom the recipient comes into contact, and to the general public. It is also important to note that the financial separation requirement is distinct from the non-subsidization requirement. While bookkeeping can demonstrate a lack of subsidization, the regulation explicitly states that mere bookkeeping separation is insufficient to meet the physical and financial separation requirement. Taken together, the recipient and the other organization engaged in LSC restricted activities must operate as two separate entities (that may collaborate) and cannot operate as essentially one entity with administrative separation on paper. In addition to Part 1610, LSC has issued a

OLA External Opinion # EX-2003-1008

May 8, 2003

Page 4

Proposal of April 25, 2003

Legal Separation of Organizations

Paragraph 1 (Legal separation) of the proposal addresses this factor, seeking

employees who work for both organizations. Such information would be useful as further indicia that the LSC grantee is not subsidizing the non-LSC entity by documenting that work on restricted activities is being undertaken by the shared employees only in their capacity as employees of the non-LSC entity. Similarly the LSC grantee should be able to show that no LSC funded resources are used for restricted activities. Information on how the affiliate organizations will apportion value for expenses would be useful. While certain expenses can be tracked with relative ease (such as use of fax machines, phones, copiers, etc.) other expenses may be harder to apportion (such as utilities, website costs, etc.), particularly to the extent that the organizations expect to share equipment and facilities. It would be helpful to us in conducting a Part 1610 assessment to have some sense of how it is intended that those apportionments be made.

The proposal inaccurately cites 45 CFR Part 1612 as if it were a general accounting regulation and mischaracterizes Part 1630 as an accounting regulation. Part 1612 deals with specific restrictions on the use of LSC funds for lobbying on legislative and regulatory proposals and §1612.10 sets forth recordkeeping requirements to document compliance with that Part. Part 1612 and §1612.10 do not impose generally applicable accounting requirements related to other restrictions. LSC's general accounting standards are found in the LSC Accounting Guide for LSC Recipients. Moreover, LSC's Cost Standards and Procedures regulations at 45 CFR Part 1630, while providing useful information on cost allocations standards for LSC funds, do not constitute an "approval" of any specific accounting procedures. Regardless of any Part 1610 issues, all grantees must fully comply with Parts 1612 and 1630. The requirements of these, and other regulations, may be helpful in determining program integrity, but Part 1610 may require additional documentation beyond the requirements of other LSC regulations. For example the LSC timekeeping requirements are not structured to provide the kind of information that might be necessary to demonstrate compliance with the transfer, subsidy, and physical and financial separation standards.

Physical and Financial Separation

Paragraphs 2 (Names), 3 (Boards), 5 (Timekeeping), 6 (Signage), 7 (Equipment), 8 (Physical Premises), 9 (Time) and 10 (Intake) of the proposal implicate physical and financial separation issues. As noted above, the physical and financial separation analysis is a fact-specific, totality of the circumstances analysis that requires consideration of all of the different indicia of separation (the most important of which are identified in the regulation, as discussed above), taken together. The proposal does not contain sufficient detail regarding several of the indicia to make a definitive determination. LSC must evaluate the proposal based on the minimum amount of separation consistent with the broad parameters that it sets out. On the basis of the information provided, the proposal does not meet the physical and financial separation standard, for many of the same reasons the 1997 Queens Legal Services situation was rejected. Nonetheless, LSC is prepared to reevaluate this proposal if sufficient additional detailed information is provided that clarifies or eliminates some of the issues discussed below.

For the purpose of understanding which aspects of the proposal are either lacking in detail or indicate a lack of physical and financial separation, the specific aspects of the proposal touching on physical and financial separation are discussed in greater detail below. The overall

conclusion regarding the physical and financial separation analysis does not hinge on any single factor; rather the entire situation is considered as a whole.

Paragraph 2 (Names) states that the “non-LSC grantee affiliate will be named in a manner that conveys its separate legal, financial and programmatic status.” While this is good as a stated goal, LSC needs the actual names of the grantee and the new entity to make a determination whether the names to be used will, in fact, sufficiently convey the separate legal, financial and programmatic status of the affiliate organization. In the Queens situation, the affiliate organization was named “Queens Legal Services II” – a name which LSC found insufficient, in light of the other ways in which the organizations were not separate, to convey separate legal, financial and programmatic status to clients, courts, agencies, the public and others with whom Queens Legal Services would be dealing.

Paragraph 3 (Boards) states that the “Membership of the non-LSC grantee affiliate Board of Directors *may consist of some or all* of the persons who sit on the LSC grantee Board of Directors” (emphasis added). Part 1610 permits the overlap of governing Boards between recipients and other entities engaged in restricted activities. However, the proposal gives no indication of the extent of the intended overlap and explicitly contemplates that there could be 100% overlap. Again, relative Board composition is viewed in the overall context of the relationship, but a 100% overlapping Board would indicate far less physical and financial separation than would Boards having less than 50% overlap, for example. Moreover, the proposal does not speak to the independence of action between the two Boards. For example, would each Board meet separately and maintain separate records? To what extent, if at all, would the Board of one organization have the ability to direct the policies, employees and activities of the other? Would there be a Memorandum of Understanding between the organizations setting forth the contractual obligations between the parties? Would the board of one have the power to appoint the members of the other? What would it say? Clarification of these issues would be needed before LSC could adequately determine how this factor would weigh in the overall physical and financial separation analysis.⁴

Paragraph 5 (Timekeeping). As described in the *Transfer and Subsidization* section above, the proposal appears to state that legal personnel working on LSC funded matters will keep time in a manner consistent with the LSC timekeeping regulation. To demonstrate physical and financial separation, it would be helpful for *each* organization to require *its own* legal employees to keep detailed time records of work performed. Such an arrangement would bolster the case for physical and financial separation as described above. This paragraph, however, does

⁴ For example, LSNY is currently restructuring itself in a way that would raise considerable Part 1610 issues if it were to extend to entities engaged in restricted activities. As LSNY has explained to LSC, the new structure will make the former grantees “child” corporations to LSNY as the corporate “parent.” LSNY will be the sole member of the child corporations, will have extensive control over their management and will directly employ staff at the child corporations. While this structure is completely permissible among entities that do not engage in restricted activities, it could be problematic for LSNY to apply it to an entity doing LSC restricted work depending on the totality of the circumstances.

not address timekeeping for non-legal (i.e., support) personnel. It would be helpful to have clarification of this issue. Furthermore, as mentioned above, Part 1610 compliance may require tracking information beyond what the LSC timekeeping regulation mandates (and which would be unnecessary if imposed on all LSC grantees, even those without affiliations raising Part 1610 questions).

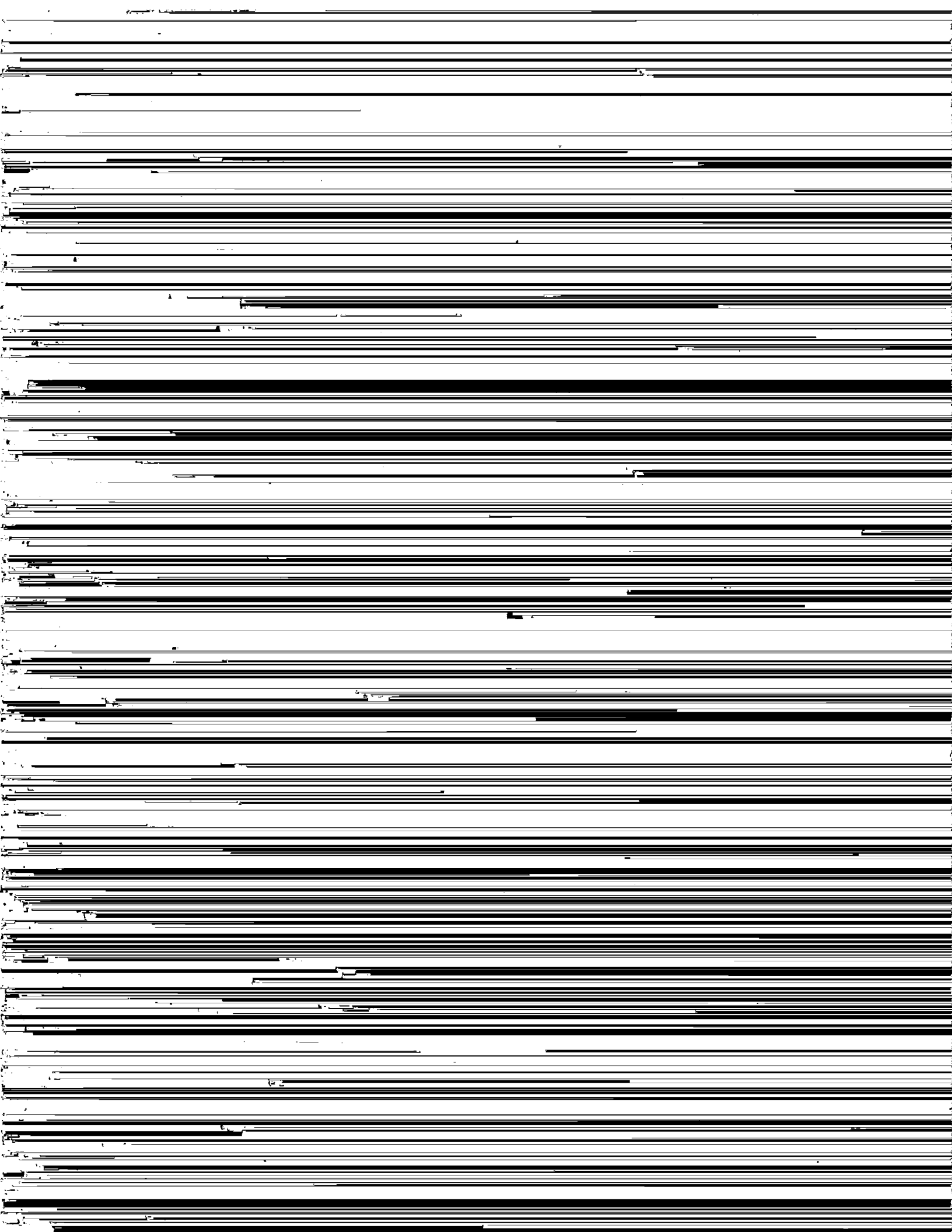
Paragraph 6 (Signage), similar to paragraph 2, contains a conclusory statement that signage and disclaimers will be sufficient to demonstrate the separate identities of the respective organizations, but fails to describe sufficiently what the signage and disclaimers would say or where they would be placed. Some of the information provided, such as the statements regarding signage to be displayed on the front doors and waiting areas and contacts with the media would be positive indicia of separation. However, there are other aspects which need clarification. For example, the proposal states that a “written explanation will be made available to all persons entering the premises” Is it contemplated that a pamphlet will be provided individually to clients and prospective clients, or merely that a statement will be posted somewhere in the building (and, if the latter, where)? Is there provision for the explanation to be in languages other than English? How will the disclaimer be transmitted to persons who contact

OLA External Opinion # EX-2003-1008

May 8, 2003

Page 8

separation. And, again as with equipment, the fact

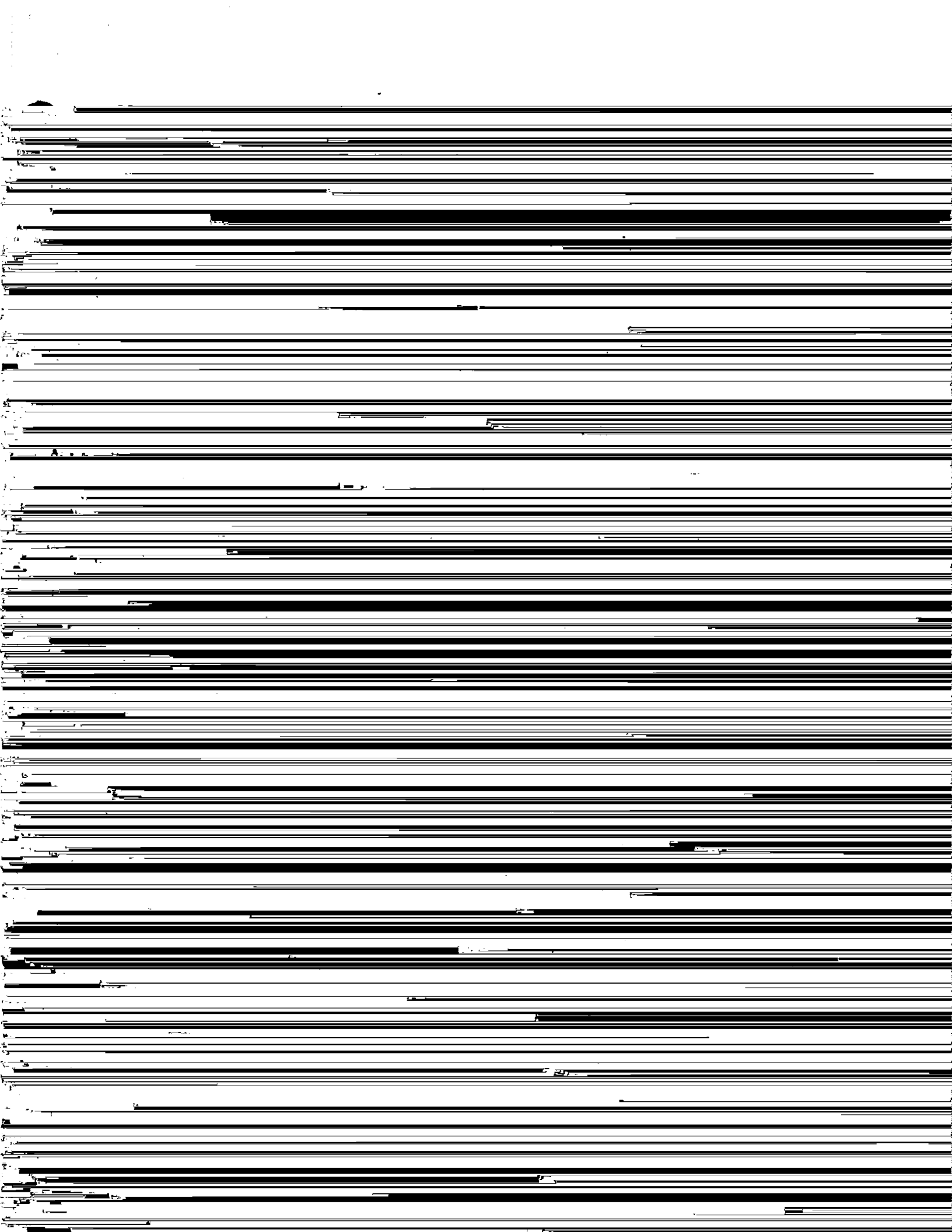


that LSC funds do not subsidize activities that the LSC Act or LSC appropriations bills bar LSC from funding will include the following established procedures:

6 **Signage and Disclaimers** The FAA

[The remainder of the page is obscured by dense horizontal black lines, rendering the text illegible.]





INSTRUCTIONS FOR CERTIFICATION OF PROGRAM INTEGRITY

- B. Transfers of program funds.** Except to support its private attorney involvement activity under 45 CFR Part 1614,² an LSC recipient may not transfer LSC funds to an organization which engages in restricted activity. Recipients may transfer non-LSC funds

**Instructions for Certification
of Program Integrity**

If the recipient employs any of the same personnel, donates to, or shares or utilizes office

- a. **the name of the organization with whom the recipient jointly utilizes facilities or equipment,**
- b. **what facilities and equipment are jointly utilized.**

**Instructions for Certification
of Program Integrity**

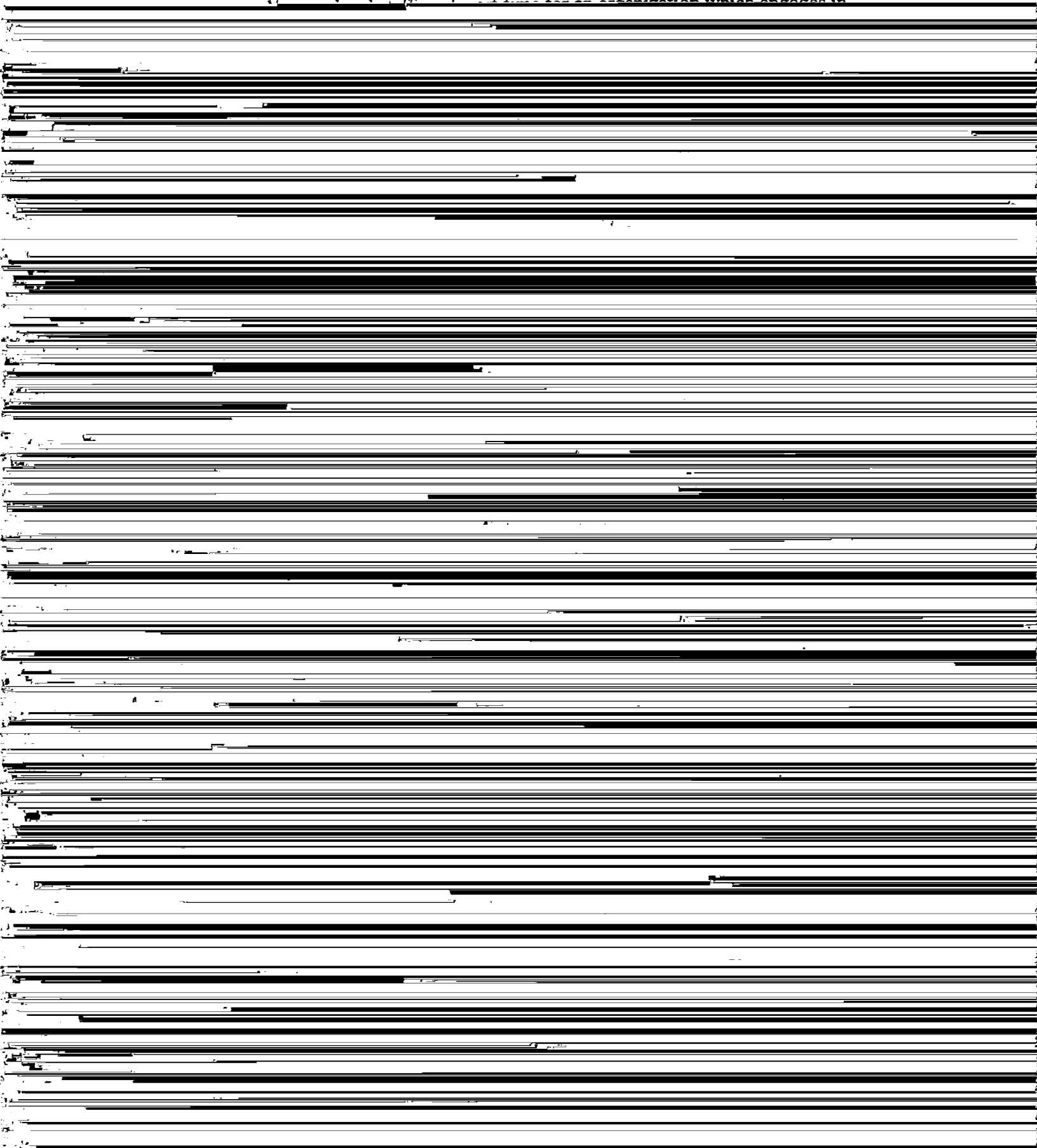
GUIDANCE IN APPLYING THE PROGRAM INTEGRITY STANDARDS

activity *only if* the transfer is to support the recipient's private attorney involvement activity under 45 CFR Part 1614. Recipients may transfer *non-LSC* funds to an organization which engages in restricted activity only if the recipient maintains objective integrity and independence from the transferee organization.

Private attorney involvement A recipient may transfer LSC funds to an organization that



... for an organization which engages in



[The main body of the page is completely obscured by dense, horizontal black lines, rendering the text illegible.]