



LEGAL SERVICES CORPORATION

750 1st St., NE, 11th Fl., Washington, D.C. 20002-4250

(202) 336-8800

Fax (202) 336-8959

Alexander D. Forger
President

Writer's Direct Telephone
(202) 336-7264

MEMORANDUM

To: Program Directors

From: John A. Tull, Director *John A. Tull*
Office of Program Evaluation, Analysis & Review

Subject: Applicability of Restrictions to Interrelated Organizations

Date: December 11, 1995

The impending adoption of significant new restrictions on the range of permitted activities for LSC-funded programs and the extension of these restrictions to all funds received by these grantees has led to the exploration in state planning processes and elsewhere of various options to allow the representation of clients on restricted matters with non-LSC funds. Such representation by organizations that do not receive LSC funds directly or by sub-grant is, of course, legitimate. However, if the non-LSC organization is so closely related to an LSC funded grantee that the two are deemed to be "interrelated organizations," all LSC restrictions will extend to both organizations.

Based on a GAO Report, dated August 22, 1985,¹ the 1986 LSC Audit and Accounting Guide, in Section 1-7, adopted a definition of and rules concerning "interrelated organizations". The standard set forth in the 1986 Audit Guide will determine when LSC will treat entities that are related to LSC recipients as interrelated organizations for purposes of determining if LSC restrictions apply to that organization. The provision in its entirety is as follows:

¹ GAO Report B-202116, August 22, 1985, entitled "The Establishment of Alternative Corporations by Selected Legal Services Corporation Grant Recipients."

BOARD OF DIRECTORS - Douglas S. Eakeley, Chairman, Roseland, NJ

Hulett H. Askew
Atlanta, GA

LaVeeda M. Battle
Birmingham, AL

John T. Broderick, Jr.
Manchester, NH

John G. Brooks
Boston, MA

Maria L. Mercado
Galveston, TX

F. Wm. McCalpin
St. Louis, MO

Nancy H. Rogers
Columbus, OH

Thomas F. Smegal, Jr.
San Francisco, CA

Ernestine P. Watlington
Harrisburg, PA

Edna Fairbanks-Williams
Fairhaven, VT

"1-7 INTERRELATED ORGANIZATIONS

For a recipient that controls or is controlled by another organization, it is presumed that combined financial statements are more meaningful than separate statements and are usually necessary for a fair presentation in conformity with generally accepted accounting principles. Control means the direct or indirect ability to: (a) determine the direction of management and policies; or (b) influence the management or policies of another organization to the extent that an arm's length transaction may not be achieved. Control is a question of fact and must be determined by the overall circumstances of the relationship between organizations. Important facts relevant to this determination are:

- (a) Extent and pattern of any overlap of officers, directors, or other managers among organizations;
- (b) Contractual and financial relationships (especially in terms of the proportion of a possibly controlled organization's funds or resources that are provided by the controlling organization);
- (c) History of relationships among the organizations (e.g. the fact that one organization provided initial funding and named initial directors of another would be a relevant fact; as would facts relating to decision-making on policies or transactions of mutual interest; actual control of particular decisions);
- (d) Close identity of interest;
- (e) One organization has become a mere conduit, "incorporated pocketbook," or "straw" party for another whether or not there was an attempt to work an injustice or promote a fraud;
- (f) Funds are solicited by a separate entity in the name of and with the expressed or implicit approval of the recipient and substantially all of the funds solicited are intended by the contributor or are otherwise required to be transferred to the recipient or used at its discretion or direction;
- (g) A recipient transfers resources to another entity that holds these resources for the benefit of the recipient; and,
- (h) A recipient assigns functions to an entity whose funding is primarily derived from sources other than public contributions.

These facts and all relevant facts must be carefully weighed in each situation to determine whether control exists; if there is a basis for a reasonable doubt as to whether control exists, that basis should be disclosed by the recipient. There is a presumption that an ongoing relationship between a recipient and a bar association does not constitute an interrelationship as contemplated in this section.

If one organization controls another but the financial statements are not combined, the facts of the relationship shall be disclosed along with a statement as to the reasons why combined financial statements were not presented and the financial statements of controlling or controlled organizations shall be included. If financial statements are combined, the facts of the relationship shall be disclosed.

Funds held by an organization which controls, is controlled by, or is subject to common control with, a recipient or subrecipient, are subject to the same restrictions as if the funds were held by recipient or subrecipient. (emphasis added)

Regardless of whether a recipient has chosen to be subject to the 1981 or the 1986 Audit and Accounting Guide,² LSC will consider the funds of interrelated organizations to be subject to all the restrictions on the use of non-LSC funds that would apply to the recipient, even if the interrelated organization does not formally receive any LSC funds. The basis for this policy is that the presence of effective control indicates that LSC funds are being used for the interrelated organization's operations even though the formal accounts may not show this clearly.

A determination as to whether "control" is present such that an organization is actually an interrelated organization, or whether the two organizations are subject to common control, must be based on whether such control in fact exists, considering the totality of the circumstances. It is a factual test, not a numerical one. Thus, the presence or absence of any one or more of these factors is not determinative.

² While the LSC Board has adopted a new 1995 Audit Guide, it does not supersede this portion of the 1986 Audit and Accounting Guide.