DECISION

THE COMPTROLLER GENERAL
OF THE UNITED STATES
WASHINGTON, D.C. 20548

FILE: B-196794 DATE: September 30, 1983

MATTER OF: Department of Labor--Interest on Recovered Grant Funds

DIGEST:

1. Where subgrantee of CETA grant to State of Arkansas earned interest on recovered FICA taxes before the recovery was returned to the Federal Government, the interest is an applicable credit under the grant agreement and grant cost principles. As a result, all interest earned by subgrantee on the recovery is owed to the grantee and by the grantee to the Department of Labor to the extent not offset by allowable grant costs.

2. Where a subgrantee of State CETA grantee recovers grant funds and earns interest on recoveries, the interest is not held on advance basis and is not exempt from accountability under the Intergovernmental Cooperation Act of 1968, 31 U.S.C. § 6503(a).

This decision is in response to a request from the Assistant Secretary for Administration and Management, Department of Labor (DOL) for our opinion concerning the treatment of interest earned by a subgrantee on grant funds held under the Comprehensive Employment and Training Act (CETA), 29 U.S.C. § 801 et seq.

The DOL requests that we concur with its position that a subgrantee of a CETA grant to a State cannot retain interest earned on grant funds after they were disbursed and subsequently recovered by the subgrantee. For the reasons given below, we concur with the Department's position.

During the period covering fiscal year 1974 through 1977, DOL made CETA grants to the State of Arkansas (grantee) that in turn made subgrants to the Southeast Arkansas Economic Development District, Inc. (subgrantee). A portion of the grant funds were used by the subgrantee to pay Federal Insurance Contributions Act (FICA) taxes (26 U.S.C. §§ 3101 et seq.) to the Internal Revenue Service (IRS). See 29 C.F.R. § 98.25(c) (1981). Subsequently,

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the subgrantee obtained a waiver from IRS of the requirement that it pay FICA taxes and in 1978 the subgrantee received a refund of all of the FICA taxes the subgrantee had paid during the 4-year period in question. The FICA taxes the subgrantee paid to the IRS included both the employer and employee share of the taxes.

Upon receipt of the refund from IRS, the subgrantee invested the money in certificates of deposit. It was not until this situation was revealed through an audit performed by the grantee in September 1980, that the subgrantee returned any of the funds involved to DOL. However, while the subgrantee apparently returned most of the principal to DOL in November 1981, the subgrantee retained accrued interest as well as a portion of the principal that was still owed to the employees the subgrantee had been unable to locate. The latter amount represents the employees' share of FICA taxes that had been withheld from their wages.

The subgrantee cites 59 Comp. Gen. 218 (1980) as authority for its retention of interest on the IRS refund. That decision concluded that non-governmental subgrantees of States were entitled to keep interest earned on grant funds advanced to them by States pending their disbursement for grant purposes under the authority of the Intergovernmental Cooperation Act, 31 U.S.C. § 6503(a). However, as discussed below, the funds at issue here were recoveries of funds previously expended for grant purposes. Hence, they were not advances as that term is defined by relevant implementing regulations, and they should have been applied to grant purposes upon receipt or returned to the Government until needed for grant purposes. More importantly, the recovered funds clearly were not held "pending disbursement" as contemplated by the Intergovernmental Cooperation Act since they were instead invested for a period of years and except for repayments of some employees' shares of the tax refund, neither the refunded amounts nor the investment interest were ever applied to grant purposes.

The Grant Agreement Forms Basis for Treatment of Interest.

When a grantee accepts grant funds, it enters into a contractual agreement. 50 Comp. Gen. 470, 472 (1970). This agreement usually is comprised of the grant application, standard Government award documents, special conditions placed on the award, grant manuals provided by the awarding agency, regulations and legislation. Among the fundamental understandings embodied in a grant agreement which flow from the authorizing statute are that grant

funds are to be expended only for the purposes for which they were awarded and are not intended to be used for the profit of the grantee unless expressly agreed to or authorized. See 42 Comp. Gen. 289 (1962). Accordingly, these funds may not be used for the purpose of earning income where to do so would be inconsistent with the purposes of the grant. Indeed, agencies have no authority to agree to such an arrangement in the absence of some affirmative legislative action permitting them to do so. B-192459, July 1, 1980.

Where, as here, grant funds are invested and earn interest, the treatment of this interest must fall under one of the rules regarding the treatment of grant-related receipts. The regulations recognize three basic categories of receipts: (1) interest earned on grant funds held in advance of immediate cash needs; (2) grant-related income derived from the grantee carrying out grant purposes; and (3) applicable credits which are those debits and credits to the grant cost items that are incidental to the operation of the grant program but are not the natural outcome of accomplishing grant purposes.

"Applicable credits" are defined as "those receipts or reductions of expenditure-type transactions which offset or reduce expense items allocable to grants as direct or indirect costs." OMB Circular A-87, Attachment A, paragraph C 3 (formerly Federal Management Circular (FMC) 74-4)) incorporated by DOL in 41 C.F.R. § 29-70.103(a) (1982). The circular gives the following examples of "applicable credits" that involve receipts: rebates, recoveries or indemnities on losses; sales of publications, equipment scrap; and income from personal or incidental services. This description of applicable credits has remained consistent in each of the circular's versions from Bureau of the Budget Circular No. A-87 (1968), Attachment A paragraph C 3, through FMC 74-4 (1974), Attachment A, paragraph C 3 to the current OMB Circular A-87, Attachment A, paragraph C 3.

It seems apparent from a review of the three categories of receipts that may come to a grantee or subgrantee that the interest earned in this instance must be classified as an applicable credit. As discussed below, the interest earned on recoveries is not interest earned on an advance of grant funds. Nor does it meet the basic definition of grant income.

First, the refunded amounts themselves clearly are credits because they are "recoveries" under the applicable definition of "credits" and it seems therefore any interest earned on such credits should also be treated as credits. Further, under Treasury Circular 1075 and the Intergovernmental Cooperation Act, as embodied in DOL regulations, grantees are not to hold grant funds in excess of their immediate needs. 29 C.F.R. § 98.2 (1978). By holding recoveries that should either have been re-disbursed for grant purposes or returned to the Government, the subgrantee violated this clear requirement.

As Applicable Credits the Interest Should Have Been Applied to Allowable Costs.

Under the cost principles applicable to the State under this grant, OMB Circular A-87 (formerly FMC 74-4) Attachment A, paragraph C 1 g, allowable costs are "net of applicable credits." 41 C.F.R. § 29-70.103 (1982). Accordingly, where interest is earned on recoveries of grant funds, this interest must be treated as added to the total amount of grant funds in the grantee's hands. To the extent that the total of grant funds exceeds allowable cost items of the grantee, these funds are returnable to the Federal Government.

The subgrantee, a non-profit organization, was subject, under regulations in effect when the taxes were recovered, to cost principles applicable to commercial organizations. 29 C.F.R. § 98.12(a) (1977). Under these standards, the subgrantee was required to treat credits as follows:

> "The applicable portion of any income, rebate, allowance, and other credit relating to any allowable cost, received by or accruing to the contractor, shall be credited to the Government either as a cost reduction or by cash refund, as appropriate. * * *" 41 C.F.R. § 1-15.201-5 (1977).

Based on the foregoing analysis, all the interest earned in this case would appear to be "applicable credits." We can see no basis for making distinctions based on whether interest was earned on funds held "pending disbursement" generally for grant purposes or whether the interest was earned on the employee's share of the tax refund held while attempting to pay employees their share of the recoveries. All of the interest is to be credited to the grant and must be included in arriving at the net allowable costs for the project. Any excess in grant funds over allowable costs is refundable to DOL at the earliest practicable time.

Employees' Share of Recovered Taxes That Has Not Yet Been Paid to Them Should be Returned to the Federal Government.

Cost regulations are also the basis for answering who should hold the employee share of the IRS refund that has not been returned to the employees. Clearly there is an obligation under this grant to pay these employees for the portion of the refunded taxes that they contributed, but the grantee is entitled to keep only those funds that represent actual costs to him. At this late date, whether these funds will ever be paid must be seriously doubted. Accordingly, they do not appear allowable under grant closeout procedures and this amount should be disallowed as a grantee allowable cost pending submission by an ex-grant funded employee of a request for payment. See 29 C.F.R. § 98.17 (1977); under 1982 DOL regulations, closeout procedures are reserved for 41 C.F.R. § 29-70.212. At this time we do not believe that amounts representing employees' share of the refunded amounts are encumbered sufficiently to permit retention as an allowed cost. Adjustments among DOL, the grantee and the subgrantee can be made at a later time, if individuals' claims are submitted, since their payment would represent costs incurred out of grant funds that were available for this purpose at the time the obligation was made.

Section 203 of the Intergovernmental Cooperation Act Does Not Apply to Interest Earned on Recovered Grant Funds.

On several occasions, going back as far as the first volume of Comptroller General decisions, we have considered situations where grantees have earned interest on advances of grant funds. See 1 Comp. Gen. 652 (1922). These cases established the rule that where grantees earn interest on advances of grant funds held pending disbursement they hold that interest in trust for the Government and must pay it over to the Government. See, e.g., 42 Comp. Gen. 289 (1962). Section 203 of the Intergovernmental Cooperation Act of 1968, 31 U.S.C. § 6503(a) (formerly 42 U.S.C. § 4213), made an express exception to this rule for States. Under this Act, States cannot be required to account to the Federal Government for interest earned on grant funds held pending their disbursement. Id. We have said that interest earned by subgrantees on advances from State grantees held pending disbursement are also excepted by operations of this Act. 59 Comp. Gen. 218 (1980). The subgrantee argues that our ruling in the last cited case controls the question presented here by DOL because the amounts refunded by IRS were being held "pending disbursement" and that, accordingly, the subgrantee should be allowed to retain the interest.

The Intergovernmental Cooperation Act of 1968, as codified in 1982, provides as follows:

> "(a) Consistent with program purposes and regulations of the Secretary of the Treasury, the head of an executive agency carrying out a grant program shall schedule the transfer of grant money to minimize the time elapsing between transfer of the money from the Treasury and the disbursement by a State, whether disbursement occurs before or after the transfer. A State is not accountable for interest earned on grant money pending its disbursement for program purposes." 31 U.S.C. § 6503(a).

The last sentence of this provision which provides the basis for the interest exemption for States and their subgrantees from our general rule does not mention the "advance" of funds. However, it is clear from the sentence that precedes it, which speaks about minimizing the time between the transfer and disbursement by a grantee, that the provision applies to advances of funds to States. This conclusion is expressly described in the legislative history of this section.

> "This section establishes a procedure to discourage the advancement of Federal funds for longer periods of time than necessary. The Department of the Treasury has already moved administratively to achieve this objective in its Departmental Circular No. 1075, issued May 28, 1964. Under this circular, a letter of credit procedure has been established which maintains funds in the Treasury until needed by recipients. Advances are limited to the minimum allowances that are needed and are timed to coincide with actual cost and program requirements. This section is designed to place this administrative practice on a legislative basis and to extend it to cover disbursements which occur both prior and subsequent to the transfer of funds. It is further intended that States will not draw grant funds in advance of program needs.
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> "Decisions of the Comptroller General of the United States have in the past required that recipients of Federal grants return to the Treasury any interest earned on such grants prior to their use, unless Congress has specifically precluded such a requirement.

> The new technique, such as the letter of credit and sight draft procedures now used by the Treasury, should minimize the amount of grants advanced, and thus it should not be necessary to continue to hold States accountable for interest or other income earned prior to disbursement." S. Rept. No. 1456, 90th Cong. 15. (Emphasis added.)

Moreover, it is unlikely that Congress, in creating an exception from the general rule on interest established by Comptroller General decisions, would have created an exemption that would go beyond the scope of that rule. The legislative history, as quoted above, confirms the limited problems addressed by section 203.

This interpretation of our cases and the Intergovernmental Cooperation Act has formed the basis for governmental policy for many years. OMB Circular A-102 provides at Attachment E, paragraph 2 as follows:

> "Interest earned on advances of Federal funds shall be remitted to the Federal agency except for interest earned on advances to States or instrumentalities of a State as provided by the Intergovernmental Cooperation Act of 1968 (Public Law 90-577) * * *." (Emphasis added.)

This provision has been in the circular in substantially the same form since 1972. DOL has adopted this policy by regulation. See, e.g., 29 C.F.R. § 98.19 (1974) and 41 C.F.R. § 29-70.205-2 (1982). As indicated, we read the Intergovernmental Cooperation Act to be directed to a specific situation concerning the cash flow management problem associated with "advances." Situations, such as that presented by this subgrantee, where disbursements are later recovered, neither meet the wording of the Intergovernmental Cooperation Act, nor are they the kind of situations it was designed to address. Accordingly, the exemption for interest earned on advances to States contained in the Intergovernmental Cooperation Act does not apply to the recoveries from IRS in this case. Our cases interpreting section 203 of the Intergovernmental Cooperation Act, as extending to subgrantees of States are, therefore, not in point and do not govern the result of this case.

CETA Section 112(c).

Finally, DOL has specifically asked in the context of this case whether section 112(c) of CETA, formerly set forth in 29 U.S.C. § 822(c), would provide a basis for saying that the subgrantee cannot be said to have always held the recovered withholding taxes pending disbursements since the time within which the grantee could re-spend the recoveries had apparently expired under section 112(c) while interest was being earned. There is no need to address this issue since whether the subgrantee was holding the funds "pending disbursement" is not a material question under this decision as to whether the interest earned by the subgrantee should be paid over to the Federal Government.

for Milton J. Socolar
Comptroller General
of the United States