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

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The Honorable
The Attorney General

Dear Mr. Attorney General:

We have reviewed the Law Enforcement Assistance Administration's (LEAA) audit of the Iowa Crime Commission at the request of Congressman Edward Mezvinsky. LEAA's audit noted that the Commission's failure to exercise prudent fiscal management of Federal grant-in-aid funds resulted in a violation of the letter-of-credit method of financing Federal grant-in-aid programs because two subgrantees apparently received subgrants in advance of need, banked the funds, and earned interest on them. LEAA required the subgrantees to return to the Federal Government the interest earned on the funds advanced to them by the Commission.

LEAA officials told us their basis for requiring the subgrantees to return such interest to the Federal Government was the Department of Justice's interpretation of section 203 of the Intergovernmental Cooperation Act of 1968, (42 U.S.C. 4213).

On the basis of our interpretation of section 203, we believe that political subdivisions receiving Federal grants-in-aid through State governments are entitled to retain moneys received as interest earned on such Federal funds. Accordingly, we recommend that you direct LEAA to recognize that local units of government should not be held accountable for such interest.

The basis for our conclusion and recommendation follows.

Section 203 provides:

"Heads of Federal departments and agencies responsible for administering grant-in-aid programs shall schedule the transfer of grant-in-aid funds consistent with program purposes and applicable Treasury regulations, so as to minimize the time elapsing between the transfer of such funds from

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> the United States Treasury and the disbursement thereof by a State, whether such disbursement occurs prior to or subsequent to such transfer of funds, or subsequent to such transfer of funds. States shall not be held accountable for interest earned on grant-in-aid funds, pending their disbursement for program purposes." (Emphasis supplied.)

The term "State" is defined by section 102 of the act (42 U.S.C. 4201(2)) as

> "* * * any of the several States of the United States, the District of Columbia, Puerto Rico, any territory or possession of the United States, or any agency or instrumentality of a State, but does not include the governments of the political subdivisions of the State." (Emphasis supplied.)

From information available to us, it appears that various Federal agencies have differing opinions as to whether they can require local units of government (subgrantees) to refund interest earned on Federal grant-in-aid funds advanced to a State for subsequent award to subgrantees. In a memorandum dated November 15, 1971, from the former Assistant Attorney General, Office of Legal Counsel to the Administrator, Law Enforcement Assistance Administration (Justice memorandum), the view is taken that local units of government are responsible for repaying interest earned on Federal grants-in-aid prior to their disbursement of the funds. Pointing out that prior to the enactment of section 203 both States and political subdivisions were required to repay any interest earned, the former Assistant Attorney General states:

> "Perhaps the most persuasive argument against a plan to hold a State accountable for interest earned is the categorical provision in §203 stating 'States shall not be held accountable for interest earned on grant-in-aid funds, pending their disbursement for program purposes.' We do not find a contradiction to that clear statement in the Act nor in its legislative history. And the most

persuasive argument for holding the heads of Federal departments and agencies responsible for minimizing the time elapsing between the transfer of funds from the United States Treasury and the disbursement of the funds by a State so as to prevent buildups is the directive in the first sentence of §203 which places that responsibility on the 'heads of Federal departments and agencies.'

"A conclusion is not as clear with respect to applicability of the waiver of interest accountability when a subgrant or direct categorical grant of funds is to cities or local units. Section 203 speaks only of relief to 'States,' a term which under the definitions of the Act does not embrace a 'political subdivision,' a 'unit of general local government,' or a 'special purpose unit of local government.' Moreover, the general rule prior to the Intergovernmental Cooperation Act, as set forth in decisions of the Comptroller General, was to require recipients of Federal grants to return to the Treasury any interest earned on grants prior to their use unless Congress specifically provided otherwise. Thus, despite the Congressional intention to discontinue 'future application' of the interest accountability 'principal' (H. Rept. No. 1845, 90th Cong., Aug. 2, 1968) the specific mention of the States in §203 without any express legislative relief to the cities and other local units leaves unchanged the general rule calling for continued accountability by the latter, whether funds are received directly or by subgrant from a State. Although we are not aware of any reason for the distinction in §203 between 'States' and 'political subdivisions,' it nevertheless exists, and accordingly we think that as a matter of law the distinction must be maintained.

"We would add only that this conclusion with respect to units other than States does not affect the obligation imposed by the Act upon the Federal

> agencies and departments to schedule the transfer of grant funds so as to minimize the time between transfer and disbursement, thus preventing buildups in the cities and local units as well as in the States."

(Reprinted in "The Block Grant Programs of the Law Enforcement Assistance Administration (Part 2)," Hearings before a Subcommittee of the Committee on Government Operations, House of Representatives, October 5, 6, and 7, 1971, at p. 716).

On the other hand, we are in possession of a memorandum dated February 19, 1969, from the Assistant General Counsel for Education, Department of Health, Education, and Welfare (HEW) to the Assistant Commissioner for Administration (HEW memorandum), in which the contrary position is taken. That memorandum reviews the rationale of the position that local units of government are responsible to return any interest earned to the Federal agency involved and states:

> "Our principal reason for rejecting this view is the language of §203 itself. It quite literally instructs us not to hold a State agency accountable for interest earned on grant funds pending their disbursement. There is no exception to this instruction for funds that earn interest pending their disbursement by a local educational agency, or any other agency.
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> "To depart from this plain reading of §203 would require some clear indication of a different legislative intent in its enactment. No such indication is apparent. On the contrary, as the floor manager of the House bill, Mr. Reuss, pointed out--
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> > "'The first substantive title--title II--calls for improved administration of grants-in-aid to the States * * *. In addition it would relieve the States from unnecessary and outmoded accounting procedures now in effect and the maintenance

> of separate bank accounts while protecting the right of the executive branch and the Comptroller General to audit those accounts.'
>
> "Relief from 'unnecessary * * * accounting procedures' is consistent with suspension of the rule requiring the States to account for interest earned on grant funds, regardless of what agency of the State may be in possession of those funds at the time that such interest accrues. The effect of excluding political subdivisions from the term 'State' must be understood merely to withhold interest forgiveness in programs in which a local educational agency is directly accountable to the Federal Government, as for example, the program of grants to local educational agencies for supplementary educational centers and services authorized by §304 of ESEA."

Both the Justice memorandum and the HEW memorandum agree that local governments are required to return to the Federal Government interest earned on advances of grant-in-aid funds awarded directly to them. Prior decisions of this Office have so held (see, for example, 42 Comp. Gen. 289 (1962)), and section 203 of the act, by excluding political subdivisions from the definition of States, would not affect this view.

There is nothing, however, in the act itself or its legislative history which covers the situation in which the grant is made to the State with the intent that such funds be passed on to political subdivisions for program purposes.

The purposes to be met and the need for section 203 is explained in the Senate Report which accompanied S. 698, 90th Congress, the derivative source of the Intergovernmental Cooperation Act of 1968, as follows:

"SCHEDULING OF FEDERAL TRANSFERS TO THE STATES

"Section 203 requires Federal agencies and departments to schedule their transfers of grant funds, consistent with program purposes and Treasury regulations, in a manner that will minimize the time between the Treasury transfer and the disbursement by the State.

"Furthermore, the section provides that States shall not be held accountable for the interest earned on the grant funds, pending their disbursement for program purposes."

"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.

"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 techniques, 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.

The issue was also briefly considered and discussed in Chapter VIII of House Report 92-1072, 92d Congress, dated May 18, 1972, entitled "Block Grant Programs of the Law Enforcement Assistance Administration," pp. 78-86.

It appears from the aforequoted legislative history that in order to minimize the amount of grant funds advanced prior to their use and hence the amount of interest paid by the Federal Government and earned by the grantees, section 203 of the act was enacted to require that funds granted to the States must be transferred in a manner which will minimize the time elapsing between the transfer of such funds and their ultimate disbursement. The primary responsibility for timing transfers was placed with the heads of the Federal agency or department concerned with the States also having a responsibility to assure that funds are not drawn in advance of program needs. (See Chapter VIII, House Report 92-1072, supra). The Congress apparently added the last sentence of section 203 in anticipation that by minimizing the lag time, the interest earned would be minimal and that there would be no need to require the States to maintain burdensome accounting procedures to account for any interest earned.

Section 203 exempts States from accountability for interest earned on grant-in-aid funds received by them and makes no differentiation between grants which the States will disburse themselves and grants involving funds which will be subgranted by the States. Moreover, we have found nothing in

the legislative history of section 203 or in subsequent hearings which makes such a differentiation. Thus, it seems clear to us that States are not to be held accountable for interest earned on any grant-in-aid funds pending their disbursement, whether or not the States intend, or are required by the terms of the grant, to subgrant these funds. To hold otherwise would, of course, require the States to assume the burden of accounting for the presumably relatively small amounts of interest which would be earned on these funds in contravention of the legislative intent behind the last sentence in section 203. Accordingly, we believe political subdivisions receiving Federal grants-in-aid through State governments are entitled to retain moneys received as interest earned on such Federal funds.

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We appreciate the cooperation your staff provided us during this review.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States