

DECISION

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

FILE: B-213909**DATE:** November 28, 1984**MATTER OF:** Agency for International Development -
Interest Earned on Grant Funds by Foreign
Government**DIGEST:**

The United States cannot recover interest earned by local and provincial elements of the Egyptian Government on grant funds awarded by the Agency for International Development (AID) to the Government of Egypt in the Basic Village Services Project (BVSP). Since the statutory provision under which the BVSP was funded contains broad program authority and since the stated purpose of the grant was to support Egypt's policy of decentralizing authority for development activities, we believe that the disbursement of the grant funds by the Egyptian Government to the lower governmental levels was a legitimate and proper purpose of the grant entitling them to retain the interest earned on the grant funds.

FACTS

This decision is in response to a request from the Inspector General (IG) of the Agency for International Development (AID) for a legal opinion from our Office as to whether the United States can recover interest earned by a foreign Government on AID grant funds. The IG's specific question concerns interest earned by local and provincial elements of the Egyptian Government on grant funds awarded by AID to the Government of Egypt in the Basic Village Services Project (BVSP) in the 1981 fiscal year.^{1/} For the reasons set forth hereafter, it is our view that the interest was earned after the grant funds were applied to a legitimate grant purpose and therefore cannot be recovered by the United States.

The BVSP was authorized on August 28, 1980, pursuant to section 532 of the Foreign Assistance Act of 1961, as amended,

^{1/} The submission we received from the IG also raised questions about the interest earned by the host government in two other grant programs--Development Decentralization and the Agriculture Cooperative Marketing Project. However, the IG's office subsequently agreed informally to limit the scope of the inquiry to the BVSP only.

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22 U.S.C. § 2346a. Under the terms of the grant, AID agreed to provide \$20 million to the Arab Republic of Egypt to assist that country in implementing the BVSP. Article 2 of the Grant Agreement describes the purposes of the BVSP as follows:

"The Project * * * consists of technical and capital assistance for the design, management and construction of basic village services in Egypt in support of the policy of the Grantee to decentralize authority for development activities. It will focus on improving and expanding a continuing capacity in governorates and villages to plan, manage, finance, implement and maintain locally chosen and constructed rural infrastructure projects. The project will finance technical advisory services, training and research and evaluation. In addition it will finance the construction of locally selected infrastructure projects. * * *"

Under the terms of the grant agreement, and its annexes, AID deposits funds in the account of the organization for the Reconstruction and Development of the Egyptian Village (ORDEV) after annual implementation plans are approved for each of the designated governorates (or provinces). ORDEV then allocates the funds to the governorates for approved subprojects. Each governorate in turn disburses the funds to the appropriate village council which makes payments to contractors as the projects are being completed.

An audit report on the BVSP, dated April 29, 1982, issued by AID's Regional IG in Cairo, indicated that as of December 31, 1981, AID has disbursed approximately \$31 million in BVSP grant funds to ORDEV. More importantly, the audit found that as of that date the governorates and village councils participating in the Project had earned over \$1 million in interest on the BVSP grant funds by depositing them in special interest-bearing accounts at the governorate and village levels. The audit report took the position that the BVSP Grant Agreement "requires" that interest earned on grant funds in the governorate and village accounts be returned to AID by the Egyptian Government. This consideration was based primarily on section D(2)(e) of the Grant Agreement's Standard Provisions Annex which reads as follows:

"Any interest or other earnings on Grant funds disbursed by A.I.D. to the grantee under this Agreement prior to the authorized use of such funds for the Project will be returned to A.I.D. in U.S. Dollars by the Grantee."

In response to the recommendation contained in the audit report that AID recover all of the interest that was earned by the governorates and village councils, AID's General Counsel took the position, in a memorandum dated June 6, 1983, that once the grant funds had been disbursed by ORDEV to the special accounts of governorates and village councils "they are deemed to have been disbursed for an 'authorized use' under the Grant." Accordingly, the General Counsel concluded that the interest earned on the grant funds at these lower governmental levels were not subject to refund under the grant agreement.

In light of the continuing dispute between AID's IG and General Counsel, the IG submitted the question to our Office for our legal opinion. The IG's submission states that under the so-called "augmentation rule," which provides that an agency may not increase or augment its appropriation from outside sources without specific statutory authority, interest earned by a grantee on funds advanced by the United States must be accounted for as funds belonging to the United States. Therefore, the IG concludes that such funds must be recovered and deposited in the Treasury as miscellaneous receipts. The IG rejects the General Counsel's view that disbursements to the special account of governorates and village councils constitute an "authorized use" of the grant fund. In this respect, the IG summarized the position of his office as follows:

"The 'augmentation rule' discourages the accumulation of U.S. Treasury funds in grantee accounts by requiring a return of any interest earned to the U.S. Government. However, in certain instances AID has allowed an exemption from this rule by defining the beginning of a project's 'authorized use' of funds as being from the establishment of grant fund accounts for the purpose of AID-financed projects. Project funds were then transferred from the grant accounts to interest bearing host government time deposit conduit accounts for long periods prior to use for project purposes. By defining these host government conduit accounts as a

legal method of earning interest on AID grant funds, since they were set up after the point of 'authorized use of funds' had been established, millions of dollars of interest earned by the conduit accounts are lost to the U.S. Treasury each year. In addition, this practice can be an incentive to delay use of U.S. funds for the purpose for which provided and appears to be an attempt to avoid the Congressional intent of the 'augmentation rule.'

"The 'augmentation rule' needs to be applied to these cases to prevent the diversion of foreign assistance funds to interest bearing host government bank accounts and to prevent this easily manipulated definition from being extended to a broad range of U.S. grant fund accounts."

ANALYSIS

Both the IG and the General Counsel agree that the determining factor in a case of this type is whether interest was earned before or after the grant funds were applied to an authorized grant purpose. Thus, in this case the critical issue is whether the central Egyptian Government's disbursement of the grant funds to the governorates and village councils constituted an authorized use of grant funds under the specific terms of the BVSP grant and the underlying legislation.

Ordinarily we would be reluctant to accept the premise advanced by the General Counsel that the transfer of grant funds from a grantee to a subgrantee, or perhaps only to a subunit of the grantee^{2/} constitutes a legitimate disbursement for grant purposes. Our reluctance in this respect is

^{2/} The precise relationship between the different elements of the Egyptian Government is unclear to us. The IG and General Counsel disputed this point as well. For example, we do not know how independent the governorates and village councils are from the central government and whether the central government had the right to demand the grant funds be returned once they had been transferred to the governorates and village councils. Based on our analysis of the case however, it was not necessary for us to resolve this issue.

based on the general rule that interest earned by a grantee on funds advanced by the United States belongs to the United States rather than the grantee and must be paid to the United States, except as otherwise provided by law. 62 Comp. Gen. 701 (1983); 59 Comp. Gen. 218 (1980); 42 Comp. Gen. 289 (1962), and cases cited therein. Grantees are considered to hold the advanced funds in trust for the United States pending their applications for grant purposes, id. The rationale for this rule is that statutes authorizing grant programs contemplate 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. Agencies do not have the authority to agree to allow the grantee to earn and retain interest on grant funds prior to their expenditure unless such authority is expressly provided. See 62 Comp. Gen. 701, 702 (1983). The major source of authority allowing retention of interest is provided States and State instrumentalities under the Intergovernmental Cooperation Act of 1968, 31 U.S.C. § 6503(a). In this case AID does not claim that an exception to the general rule such as the Intergovernmental Cooperation Act provides the basis for the grantee to retain the interest. The AID position is that the general rule is satisfied because the interest was accrued in furtherance of the grant purpose. Section 531(a)(1) of the Foreign Assistance Act of 1961, as amended, 22 U.S.C. § 2346(a)(1), under which the BVSP was authorized and funded, contains very broad program authority:

"The Congress recognizes that under special economic, political or security conditions the national interest of the United States may require economic support for countries or in amounts which could not be justified solely under chapter I of part I of subchapter I of this chapter. In such cases, the President is authorized to furnish assistance to countries and organizations on such terms and conditions as he may determine, in order to promote economic or political stability. * * *" (Emphasis added.)

Clearly this language was intended to provide the President, and by extension AID, with a considerable degree of discretion in the design and implementation of grant projects so as to best accomplish the agency's programmatic objectives.

We think that AID can make grants under this authority for the purpose of providing grantees or subgrantees with experience in managing, handling, and by implication, investing project funds, including the right to earn and retain interest thereon. In this respect it is significant that AID's program office which designed the grant project here in question, and AID's General Counsel, which provides legal guidance to that office, are convinced that the grant was designed and implemented to accomplish such objectives by making disbursement of grant funds to the lower governmental levels--governorates and village councils--a material purpose of this grant.

Our analysis of the grant agreement and supporting documentation leads us to the same conclusion reached by the General Counsel. That is, we believe that disbursement of the grant funds to the governorates and village councils for their management was a legitimate and proper purpose of this grant.

As mentioned above, the grant agreement states that the purpose of the grant is to support the grantee's policy of decentralizing authority for development activities in Egypt by focusing "on improving and expanding a continuing capacity in governorates and villages to plan, manage, finance, implement and maintain" locally selected projects. The project description in Annex I of the grant agreement emphasizes that the primary purpose of the BVSP is "decentralization."

Descriptions and explanations of the purpose and objectives of the BVSP contained in the BVSP Paper, dated July 22, 1980, a document which justifies and explains why the grant should be approved and how it would be implemented, are more specific. For example, Annex III of the BVSP Paper contains a cable dated June 9, 1980, from the Near East Bureau of the State Department approving further development of the BVSP proposal. The cable reads as follows:

"* * * project purpose must stress acceleration of decentralization and increase of institutional capacity to plan, implement, monitor and fund local development activities rather than construction of rural infrastructure. If BVS project helps capitalize governorate fund, AID monitoring will be essentially concerned with evidence of expenditures at governorate level and selection and implementation procedures to be used at that level. * * * "

Similarly, the goal of the project is described in the Project Paper (p. 4) as follows:

"The goal of this project is to expand decision making capacity on the broadest possible basis, within the framework of Egyptian policy of using the decentralization process as a means for achieving its development objectives, by providing local government decision-makers with experience in the allocation and utilization of resources and in developing the financial and other mechanisms to carry out development programs. Such decentralization is premised on the assumption that increased local government responsibility for local development activities will result in a more equitable and self sustaining development process relevant to both national and local interests."

The grant agreement and supporting documentation is replete with other similar references that demonstrate that the primary purpose of the BVSP grant was to provide decision-makers at the governorate and village council levels with experience in all aspects of planning and executing development projects, including those relating to the handling, disbursement, and by implication, investment of funds needed to finance those projects. Thus, we believe that disbursement of BVSP funds by ORDEV to the governorate and subsequently to the village council levels did constitute an "authorized use" of grant funds.

Other information in the grant agreement and supporting documentation relating to the manner in which the BVSP funds were to be distributed and accounted for at each stage of the process lends further support to our conclusions. The following explanation of the intended funding mechanism from the BVSP Paper is especially significant in this respect:

"* * * When annual implementation plans are approved for each of the designated governorates, USAID will provide the equivalent of \$15 million to be deposited to the account of ORDEV at the Central Bank of Egypt. ORDEV in turn will issue a check for \$5 million to each of the three governorates upon certification by the governorate that the 10% maintenance fund has been established. Each governorate will then disburse the funds to the appropriate village councils for their approved projects.* * *

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"The cash management aspects of disbursing the entire annual allocation of \$15 million dollars up front prior to actual project implementation were carefully considered. An incremental funding mechanism with periodic reimbursement or replenishment was considered and rejected. The project sites and the accounting stations are so widespread, the financial reporting network so diffuse, the need for funds at the provincial level in terms of timing and amount so uncertain, it is imperative to have the funds available at the nearest control point, which is the governorate. The initial expenditure of \$15 million dollars will be a disbursement, not an advance. Periodic reporting from the GOE will indicate how the funds were used and will determine future allocations." (Emphasis added.)

As this explanation indicates, an important aspect of the funding mechanism was the disbursement of the funds to the lower governmental levels--especially the governorates--so the funds would be available where, when, and as needed. This explanation necessarily implies that the grant funds would sometimes be held at the lower governmental levels for some time until they were needed. In such circumstances, a governorate or village council that did not keep the funds in an interest-bearing account until they were needed would not appear to be acting responsibly toward achieving the primary stated purpose of the grant--developing a capacity "to plan, manage, fund, implement, and maintain" locally chosen projects.

As stated above, the primary purpose of the BVSP was to develop the capacity of governorates and village councils to participate fully in every aspect of planning, managing, and financing local development projects. Accordingly, we agree with the position of the General Counsel that the project's stated purpose would have been diminished if the governorates and village councils were not afforded full control over, and responsibility for, the BVSP grant funds once the funds were disbursed by ORDEV of the central government. This necessarily includes, in our view, the right to earn and retain interest on the funds while they were deposited in the special governorate and village council accounts required under the grant agreement.

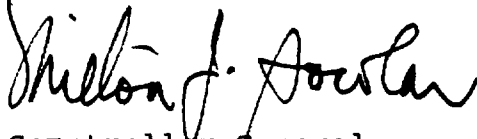
As indicated above, we believe our conclusion is entirely consistent with the relevant decisions of our Office. Both the General Counsel and the IG argue that our holding in B-192459, July 1, 1980, involving a grant by the Community Services Administration (CSA), support their conflicting positions. The CSA case involved interest earned at two different stages of grant implementation. The grant in that case was made by CSA to a hospital for the purpose of assisting in the construction of a new hospital facility. One "category" of interest was earned by the grantee hospital prior to any transfer of the grant funds. The other "category" of interest was earned by a trustee holding grant funds in a special hospital construction trust fund. Our decision held that while the interest earned by the hospital prior to the transfer of grant funds to the trustee had to be returned to the Government, citing the general rule in such cases, the interest earned by the trustee could not be recovered since the transfer of grant funds to the trustee was "an expenditure or disbursement for grant purposes." We reached the latter conclusion because the grantee had given up possession and control of the grant funds to an independent third party, from whom the grantee had no right to demand return of the funds and because the grantee had received something in exchange for the transfer of funds--the promise of new hospital construction.

In the present case, the IG maintains that his office could not find that any of the requirements established in the CSA case "were met in establishing the special accounts which served mainly as conduits for the funds to pass down the U.S. Treasury down to the project level." On the other hand, the General Counsel maintains that the test set forth in CSA was essentially satisfied in the BVSP.

The issue in this case is generally the same as the one in the CSA case--whether the transfer of funds to the governorates was a disbursement for grant purposes. However, the analysis required to resolve that issue is different because of the different purposes of the two grants. If the primary purpose of the BVSP grant had been to build or construct rural development projects--roads, water works, canals, sanitation systems, and so on--the relevant issue would be whether the transfer from the central government to the governorates satisfied the requirements set forth in our CSA decision. However, as explained above, the central purpose of the BVSP was to assist Egypt's effort to decentralize the responsibility for planning and managing such projects from the central government to the provincial and local governments.

Therefore, under CSA and our general rule in such cases, the test to be applied is whether the transfer to the governorates and subsequently the village councils was a legitimate means of accomplishing the general grant purpose of decentralization. In our view, the grant agreement and supporting documentation indicates that such was the case.

In accordance with the foregoing, it is our conclusion that in the specific facts and circumstances of this case, AID has no legal basis to attempt to recover interest earned by the governorates and village councils on the BVSP grant funds that had been disbursed to them. Nevertheless, in order to remove any possible doubt or ambiguity in the future we recommend that new grant agreements for this or similar programs more clearly address the question raised in this case. Rather than answering this question by resorting to an analysis of the grant documents, it would be clearly preferable to have a paragraph in these documents that clearly connects the program purpose with the circumstances under which a grantee or subrecipient may retain interest income.

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Comptroller General
of the United States