DEPARTMENTAL GRANT APPEALS BOARD

The Department of Health, Education, and Welfare

SUBJECT: Education Commission of the States, Denver, Colorado
Audit Control No. 08-51453
Docket No. 75-13
Decision No. 14

DATE: March 10, 1976

DECISION

Grantee is a nonprofit organization of 45 states, Puerto Rico and the Virgin Islands, established by the "Compact for Education" to provide a partnership between educational and political leadership for the advancement of education throughout the nation. An audit showed significant weaknesses in administration and accounting generally.

For the grantee's fiscal year ending September 30, 1973, and for the following quarter year, it has been determined on audit that grantee has a liability to the Federal Government for interest charges in the amount of $52,878 and that with respect to costs associated with computer operations and legal fees grantee has a liability to the Federal Government of $65,520, resulting from failure to allocate costs on an equitable basis properly to the activities involved. Both of these determinations were sustained by the Office of Education. Grantee appeals the interest liability in its entirety and the computer operations and legal fees liability to the extent of $28,930, conceding liability as to $36,590.

Imputed Interest

The interest charge is based upon a finding that grantee improperly drew down advance payments of Federal funds beyond immediate operating cash requirements of grant activities and should reimburse the Government for interest on such excessive draw-downs. Grantee apparently does not question that they were in excess of authorized operating expenses of the specific grants, the funds of which were drawn down. Grantee argues, however, that the draw-downs were made in good faith to pay operating expenses of federally funded projects for which the Federal Government had failed to provide timely financing. Grantee contends that assuming the draw-downs to be improper there is nevertheless no legal basis for requiring payment to the Government of interest imputed and not actually earned.

The grant provides for repayment to the Government of interest earned on grant funds. It does not provide for repayment of imputed interest and no provision of law, regulation or policy statement has been cited supporting the demand for repayment which appears to be contrary to well established Government-wide grant practice. The Grant and Procurement Management Division (GPMD) argues that the excess draw downs were improper, and stresses that the grantee used more than $677,000 of the improperly drawn funds for its own working capital needs. Grantee does not concede that it violated the terms of the relevant instruments, although its statement on this point is a conclusion without supporting detail. Assuming that the draw downs were improper, as they seem to have been, the Office of Education (OE) had available to it a wide spectrum of possible responses. These included possible termination if the offense were deemed clear enough and important enough, refusal to renew, renewal only on terms imposing much tighter monitoring and particularly closer fiscal controls, ranging to admonition for the future. The response selected by OE is one for which no authority is shown, although OE was specifically invited to brief the question. It runs counter to well established practice.

OE is right in feeling that the present practice is not altogether satisfactory and deserves further thought and effort at improvement. This is, however, a complex matter with important considerations pushing in opposing directions.

When grantees draw down interest-free monies in excess of the needs of the programs for which the draw downs were authorized, the Treasury is forced to incur interest costs to borrow that money. An unfair burden is clearly placed on the Government. But there are considerations on the other side to which the Government gives weight. The Letter of Credit system was deliberately designed to give grantees a margin of flexibility which experience has shown is a real need. Even daily reporting and auditing is possible but except perhaps for the largest grantees would impose on the Government monitoring costs and on the grantee reporting requirements that may be excessively burdensome. For years a practical compromise has been in effect which requires grantees to reimburse the Federal Government for interest earned on money drawn down prematurely, but not for interest imputed but not actually earned by the grantee. Moreover, in the case of states, a deliberate policy judgment has been made some years ago not to recover even interest actually earned by the grantee on money drawn down prematurely. This is a statutory rule which the agencies are not free to alter unilaterally (Sec. 203, Intergovernmental Cooperation Act of 1968 ((PL90-577; 82 Stat 1101)); cf. FMC 74-7 Attachment E; HEW Administration of Grants, 45 CFR 74.42(b); General Provisions for OE Programs, 45 CFR 100a.232, 100b.232). As an unincorporated association of states, the grantee may be legally entitled to treatment as a state. It asserts without contradiction that in practice

it has always hitherto been treated in audit as a state. In any case, a change in the established rules in this field should not be made by tinkering with solutions for a particular case. The counterbalancing considerations must be weighed on a comprehensive basis. Substantial thought is indeed being given to this problem by the Treasury and the Agencies and may result in legislative or other broad solutions taking account of the full scope of the problem.

Computer Center Costs and Legal Fees

With respect to the computer center costs and legal fees, the Office of Education has determined that such costs were not properly allocated to specific activities on an equitable basis and thus were in part not properly allowable as expenses of the Federal grants charged. In the negotiation of grantee's indirect cost rate a reallocation of these items was made resulting in an adjustment of the rate which covered these items to the extent that they were allowable at all. This adjustment is reflected in the audit report (Control No. 08-51453), page 15, and in the statement of the final indirect cost agreement dated February 24, 1975. Grantee contends that only a portion of these charges were in fact included in the indirect rate and the balance is still properly chargeable as direct costs. If, as appears from GPMD's statement, computer costs and legal costs were fully discussed, portions were challenged, and an agreed adjustment in the rate was made to cover the entirety of such costs to the extent they were to be allowed and reflected in a final rate agreed to by both parties, there would appear to be no basis for the grantee's present claim.

In its response (January 10, 1975) to the draft audit report, grantee agreed "with the audit fact that $11,669 was charged to NAEP [National Assessment of Educational Progress] in excess of proper charges," but argued that instead of being refunded they should be allocated to the general fund and reallocated through the indirect cost reimbursement system (p. 18) and that computer center costs similarly be reallocated in the indirect cost computation (p. 11). These reallocations were apparently made to the extent allowable in a negotiated rate signed by both parties. The audit recommendation concluded that the amounts involved must be removed from direct charges.

No material facts are in serious dispute. Grantee asserts that the costs now disallowed were determined to be allowable by the HEW Audit Agency. If true this would not be controlling in the fact of the contrary determination by the Regional Director. Grantee cites no documentary evidence of this, however, and has not responded with specifics but only with generalities to an express invitation to discuss this contention and in particular the concessions made in its response to the draft audit acknowledging charges in excess of proper charges.

Grantee makes a further contention that its signing of the indirect cost rate agreement did not bind it because it was a necessary step to having an appealable issue. This argument is without any persuasiveness in fact and without any merit in law.

Well known rules of grant administration which are expressly stated in the indirect cost rate agreement signed by the parties require similar costs to be accorded consistent treatment and preclude splitting a cost between direct cost treatment and indirect cost treatment. Its present attempt to get direct cost treatment for a portion of the costs which were considered but not fully reflected in the indirect cost rate runs up against that rule by which it is bound. The Agency's position, that those portions of the costs in question not covered by the adjustment made in the indirect cost rate were thereby rejected as unallowable, is further supported by this consideration which grantee has not addressed in any persuasive way although invited to do so.

Substantially the foregoing summary of the facts and issues was furnished to the parties who were afforded an opportunity to correct any misunderstanding, respond to specific questions and brief any aspect of the case they wished. Their responses have been considered and noted herein.

DECISION

The appeal is sustained with respect to the issues of recovery of imputed interest. The appeal is denied with respect to the issue of computer costs and legal costs.

/s/ David V. Dukes

/s/ Thomas Malone

/s/ Malcolm S. Mason, Panel Chairman