BY THE U.S. GENERAL ACCOUNTING OFFICE

## Report To The Secretary Of Transportation

# The Department Of Transportation Should Improve Its Policies And Practices On Grant-Related Income

Many Department of Transportation grantees generate income under programs financed in whole or in part with federal assistance. Program income is a potential source of revenue for either increasing the size of transportation programs or reducing the federal government's and grantees' share of program costs. However, these objectives were not always being attained because regulations directing the grantees' use of the income did not exist or Transportation's operating administrations and grantees were not always complying with existing regulations. GAO recommends a number of corrective actions.





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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

GENERAL GOVERNMENT
DIVISION

B-202774

The Honorable Elizabeth H. Dole
The Secretary of Transportation

Dear Madam Secretary:

We completed a governmentwide review in 1983 of federal agencies' and grantees' policies and practices for managing and reporting income generated under federally assisted programs. We found that a number of federal agencies, including the Department of Transportation (DOT), had not established regulations conforming to the Office of Management and Budget's (OMB) grant related income standards and/or were not adequately implementing agency grant related income regulations. As a result, the objectives which the income standards sought to attain--using the income to increase the size of federally assisted programs or to reduce the federal government's and grantees' shares of program costs--were not always being attained. We are reporting the findings as they relate to your agency and recommending that you direct the DOT operating administrations included in our review to comply with their grant related income regulations and adopt the OMB standards so that the income standards' objectives can be attained. Our recommendations to you appear on page 10 of appendix I.

DOT provided comments on this report, agreeing on some issues while disagreeing on others. Our evaluation of DOT comments is on page 10. As you know, 31 U.S.C. §720 requires the head of a federal agency to submit a written statement on actions taken on our recommendations. You must send the statement to the House Committee on Government Operations and the Senate Committee on Governmental Affairs within 60 days of the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made over 60 days after the date of the report.

We are sending copies of this report to the Director, Office of Management and Budget; appropriate Senate and House Committees; and other interested parties.

Sincerely yours,

W. J. Anderson

William J. Anderson
Director

# RESULTS OF GAO'S REVIEW OF INCOME GENERATED UNDER DEPARTMENT OF TRANSPORTATION ASSISTANCE PROGRAMS

## BACKGROUND

Grant-related income is any money received by grantees during the course of operating federally assisted programs. Grantees in a number of DOT programs generate income from (1) rents for land, housing, and industrial facilities collected on properties acquired with federal assistance; (2) investment income (interest) earned on grant project funds; and (3) proceeds realized from the sale of property and equipment.

OMB issued standards during the 1970's requiring grantees to account for income generated under programs financed in whole or in part with federal funds.[1]

OMB categorized different types of income by source and provided principles for each type's disposition, as follows:

--Interest earned by states or their instrumentalities on advances of federal funds pending disbursement need not be remitted to federal agencies per the provisions of the Intergovernmental Cooperation Act of 1968.

--Interest earned by others on advances of federal funds must be remitted to federal agencies.

--Proceeds from the sale of real and personal property are to be remitted to the federal government in proportion to the percentage of federal participation in the cost of the original project.

--All other program income (fees, rents, lease income, etc.) earned during the grant period is to be retained by grantees but used in one of three ways.

Circulars A-102 and A-110 specify the three available options for handling the last type of income--other program income. The grant agreement is to specify which of the following options the grantee is to use:

--**Additive:** Add the income to the funds committed to the project by the grantor and grantee and use it to

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[1]Attachment E of Circular A-102: Uniform Administrative Requirements for Grants-in-Aid to State and Local Governments, issued in 1971 (revised January 1981) and Attachment D of Circular A-110: Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals, and Other Nonprofit Organizations, issued in 1976.

further eligible program objectives. This is to result in a larger program than what would otherwise be the case.

—**Cost-sharing:** Use the income to finance the nonfederal share of the project. This is to result in the same size program. The grantee is allowed to use program income as part or all of its contribution to project costs rather than having to contribute its share from its own resources. The federal contribution remains the same.

—**Deductive:** Deduct the income from total project costs to arrive at net costs on which the grantor and grantee shares will be based. This is to result in the same size program, and unanticipated program income is used to reduce the grantor and grantee contributions rather than to increase the funds committed to the project.

These three options for handling other program income are graphically displayed in appendix II.

## OBJECTIVE, SCOPE, AND METHODOLOGY

Our review was undertaken to assess agencies' policies and practices for reporting and disposing of grant-related income. Four DOT operating administrations were included in our review--the Urban Mass Transportation Administration (UMTA), the Federal Aviation Administration (FAA), the Federal Highway Administration (FHWA), and the Federal Railroad Administration (FRA).

Federal financial assistance for transportation is provided to state and local transportation agencies by the four operating administrations through 15 programs. Because existing information and reporting systems were inadequate for determining which programs were generating income, we selected and examined four programs--FHWA's Highway Research, Planning and Construction; FAA's Airport Development Aid; UMTA's Capital Improvement Grants; and FRA's Local Rail Service Assistance--that had generated income, according to reports issued by the DOT Inspector General.

The number of states we visited and the grantees/subgrantees we contacted, by administration, are shown below.

| Administration | Number of states visited | Number of grantees/ subgrantees contacted |
|---|---|---|
| FAA | 5 | 9 |
| FHWA | 2 | 2 |
| UMTA | 5 | 6 |
| FRA | 3 | 7 |

Our selection was generally designed to yield grantees with varying dollar size grants and a combination of grants for which income was and was not reported. We interviewed grantee officials having program, administrative, and financial responsibilities and examined grantee records to verify the information obtained.

In Washington, D.C., (headquarters) and in four federal regions--New York, Atlanta, Denver, and Seattle--we interviewed DOT officials having program, grants administration, accounting, budgeting, auditing, and legal responsibilities. We examined agency records and reviewed several hundred DOT internal audit and Inspector General reports for the period 1975 to mid-1981. We used these reports, along with information we obtained from our audit work, to develop our findings. Because of the large number of audit reports reviewed, we did not verify the supporting data or pursue what corrective actions were taken. We conducted these interviews and record reviews to ascertain DOT's policies on grant-related income and to determine whether agency and grantee practices were in accord with these policies.

This audit was performed in accordance with generally accepted government auditing standards.

## GRANT AGREEMENTS SHOULD SPECIFY HOW GRANTEES MAY USE PROGRAM INCOME

OMB's program income standards provide that grant agreements are to specify the option grantees should use in disposing of program income so that federal programs benefit from the income generated through expanded programs or reduced federal and grantee costs. FHWA and UMTA have not adopted the OMB standards or issued their own regulations on program income. Thus, the operating administrations have, in effect, lost some ability to direct the grantees' use of the income with the result that some grantees either decide how to spend the income or follow provisions of state or local laws in the handling of program income.

In several cases, we found that DOT programs did not fully benefit from the income generated. For example, under FHWA's highway planning and construction program, many states generate income from leasing acquired lands and improvements thereon before or during highway construction. In New York, between April 1980 and March 1981, more than $1.6 million was generated from rentals and sales of land and buildings. According to state transportation officials, this money was deposited, in accordance with state law, to the state's general fund and was not subsequently made available for use in the highway program.

APPENDIX I

In Washington State, transportation officials told us that income generated from leases or rentals in managing property under FHWA's highway planning and construction program, approaching nearly $325,000 annually, was deposited, in accordance with state law, to the state Motor Vehicle Fund. The fund is used for both highway construction and nonconstruction activities.

Under UMTA's Capital Assistance Program, grantees receive income from leasing property acquired with federal assistance. The DOT Inspector General, in a review of seven grantees, found that the grantees had rental income of $575,000 that had not been applied to the grants which funded the purchase of the properties but, rather, to transit operating costs and other nongrant costs. The auditors recognized that UMTA had no policies on the grantees' use of the income and recommended that UMTA develop and implement policies which would enable UMTA to direct the disposition of program income.

UMTA issued draft regulations in September 1980 that specified the use of the deductive option for using program income. The deductive option calls for program income to be deducted from the total project costs for the purpose of determining the net costs on which the federal share of costs will be based. If program income is unexpectedly earned, the federal and grantee funds needed to carry out the project should be less than that reflected in the approved budget. UMTA program officials told us that although the regulations were not yet finalized, the officials intended for grantees to use the deductive option.

We found, however, that the deductive option, as implemented by UMTA, often produced the results intended by the additive option. In an audit of selected UMTA projects, the DOT Inspector General identified three projects which had program income in excess of original budget estimates. In all three cases, UMTA allowed the grantees to increase the size of the projects by the amount of the excess income. As a result, net costs to UMTA and the grantees remained unchanged even though more income was received than anticipated. The auditors concluded that if the income had been deducted from the projects, UMTA's participation would have been reduced by $182,000.

The costs of the three projects were allowed to increase above the initial grant award budget. While the increases were supported by revised budgets, this action, in effect, achieved results anticipated under the additive rather than the deductive option. Therefore, operationally, the grantee used the program income to expand the project and, for accounting purposes, subtracted the program income from the increased rather than the budgeted total costs before computing the respective federal and nonfederal shares. As a result, the program income and the additional expenditures were in

effect netted-out, and the federal share was not based on a reduced amount as intended by the deductive option.

If the deductive option is to be specified in grant awards, as is the intent of draft UMTA regulations, the procedures for using the option should stress that the grant budgets should not be allowed to increase merely because unanticipated program income materialized. To do otherwise produces results intended under the additive rather than the deductive option.

## IMPROVEMENTS NEEDED IN GRANTEES' REPORTING OF INCOME

The regulations of DOT operating administrations, except FHWA, require grantees to report program income. Grantees, however, are not always reporting the income received. Further, the operating administrations' regulations address only certain income, not other grant-related income such as interest and sales proceeds. As a result, millions of dollars of grant-related income are not being reported.

To determine the magnitude of nonreporting, we reviewed several hundred DOT Inspector General audit reports for the period 1975 to mid-1981. In 42 of these reports, the auditors found unreported income, as follows.

| | Unreported income as identified in 42 audit reports |
|---|---|
| Federal Highway Administration | $ 1,030,838 |
| Federal Aviation Administration | 1,989,918 |
| Federal Railroad Administration | 90,148 |
| Urban Mass Transportation Administration | 8,456,525 |
| Total | $11,567,429 |

Income was not reported because DOT operating administrations do not require the reporting of all grant-related income and sometimes grantees neglected to report program income. In addition, FHWA does not require the reporting of any program income.

We and the DOT Inspector General found several cases where grantees earned interest or received sales proceeds; but because of the lack of reporting requirements, DOT operating administrations were not aware of the income. For example, in New York, UMTA did not know that a grantee received $10,500 from the sale of surplus buses. In this case, the proceeds were neither remitted nor reported to UMTA at the time of the sale.

APPENDIX I

Grantees also sometimes neglected to report program income as required by FAA's, UMTA's, and FRA's regulations. For example, an Airport Development Aid Program grantee in Utah did not report program income of $3,660 as required by FAA. In New Jersey, a Local Rail Service Assistance Program grantee earned and retained, but did not report as required by FRA regulations, about $9,460 of program income.

## GRANTEES SHOULD REMIT PROPERTY SALES PROCEEDS

Regulations of UMTA and FAA require grantees that dispose of property[2] acquired with federal assistance to pay an appropriate share of the sales proceeds to the operating administrations. These regulations conform to OMB's property management standards contained in Attachment N of Circular A-102. We and the DOT Inspector General found cases, however, in which UMTA and FAA grantees were retaining rather than remitting sales proceeds.

In the projects we reviewed and in selected DOT Inspector General reports, we found that

--the New York City Transit Authority received over $45,000 from the sale of 154 buses during 1981 and retained all of the sales proceeds rather than remitting the federal share,

--the Orange-Seminole-Osceola Transportation Authority in Orlando, Florida, retained $5,005 from the sale of 14 used buses rather than remitting the federal share to UMTA,

--the Denver Regional Transportation District in 1979 sold buses and fareboxes purchased under two UMTA projects and retained the entire amount of $195,000 in sales proceeds, and

--an FAA grantee in Georgia received and retained over $674,000 from selling houses acquired under an Airport Development Aid Program land acquisition project but did not remit the federal share of the sales proceeds to FAA.

We and the DOT Inspector General did note instances of UMTA requiring grantees to remit the federal share of the

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[2]Land sales proceeds under FAA programs are subject to different regulations which authorize use of the proceeds for any airport purpose except as matching funds for any airport project or grant.

sales proceeds to the government when the administration became aware of grantees disposing of federally funded property. For example, an UMTA grantee in New York did not report $10,500 from the sale of buses. We discussed this matter with UMTA officials who subsequently required the grantee to remit a check for the federal share amounting to $8,400. DOT's Inspector General reported that as a result of a contract audit, a Denver UMTA grantee remitted a check for nearly $4,400 to UMTA for buses sold under its UMTA project.

Unlike the regulations of UMTA and FAA, FHWA's regulations on dispositions of real or personal property under the highway construction program allow grantees to credit highway projects rather than to remit sales proceeds. As noted above, however, the OMB standards provide for paying the federal government its share of the sales proceeds.

## INTEREST EARNED ON CERTAIN FEDERAL FUNDS SHOULD BE RETURNED

Under the Intergovernmental Cooperation Act of 1968, States and their instrumentalities are not accountable for interest earned on advanced federal funds pending disbursement for program purposes. However, when interest is earned on (1) sales proceeds which grantees are required to remit and (2) federal funds advanced to nonstate agencies, grantees are required to remit to the federal government such interest income earned.

The interest accountability requirement for these interest earning situations derives from the fact that the principal on which the interest is earned belongs to the government. Nevertheless, two federal transportation operating administrations have not always taken adequate steps to identify and recover the interest earned. Moreover, until recently, UMTA allowed nonstate grantees to retain interest earned and use it for project purposes. UMTA issued proposed rules in September 1980 to change the policy but as of January 1983, final regulations had not been issued.

### Interest earned on sales proceeds should be remitted

The federal transportation operating administrations we reviewed have not issued regulations on the proper disposition of interest earned by grantees on sales proceeds. We and the DOT Inspector General found that grantees have sold real or personal property, deposited and earned interest on the sales proceeds, but have not always remitted the federal share of the interest although the federal share of the sales proceeds

themselves was eventually remitted. The one operating administration reviewed by DOT auditors concerning this situation had varied practices. As a result, the federal government has not always received interest to which it was entitled.

Our review of audit reports and grantees disclosed inconsistencies in UMTA's determination of the disposition of earned interest. For example, during an audit of an UMTA grantee in Colorado, DOT auditors found that the grantee had earned $17,154 of interest on the federal share of sales proceeds. As recommended in the audit report, the grantee remitted the $17,154 to UMTA.

In another case, an UMTA grantee in Utah sold property in November 1980. It was not until January 1982 that UMTA received its share of the net proceeds. The grantee acknowledged to us that interest was earned on the sales proceeds at various rates over a 14-month period, but UMTA officials did not raise any questions on the interest earnings. We discussed this case with UMTA's regional officials who told us that the federal share of interest income would be recovered. Also, an UMTA grantee in Tennessee invested sales proceeds and earned $80,172 of interest. The auditors in this case, however, recommended that the interest be retained and credited to the project rather than returned to UMTA.

Except for FHWA, the regulations of the DOT administrations we reviewed require grantees to remit a pro rata share of sales proceeds. We believe that interest earned on these funds should similarly be remitted.

Interest earned by nonstate agencies should be remitted

Unlike states and their instrumentalities, other grantees are accountable for interest earned on advanced federal funds. Our review showed, however, that some transportation grantees are earning and retaining interest on premature advances and withdrawals of federal funds. For example:

--An UMTA grantee in New York did not return $1,886 of interest earned in 1978 and 1980 on federal funds prematurely provided under two grants. Subsequent to our discussions with UMTA regional officials, the grantee, in January 1982, remitted the interest. Department of Transportation internal audit reports have similar findings. For example, in one report, the auditors noted that during a 3-month period, $47,000 in interest was earned but not returned by three transit authorities.

--FAA grantees in Kentucky and Washington earned, but did not return, $3,710 and $8,794, respectively, in interest on FAA funds. Further, in one transportation audit

report involving five grantees, the auditors calculated that the federal government lost at least $32,000 in interest because of premature advances. In another report, the auditors noted that interest had been earned over a 3-year period and, rather than remitting it to FAA, the grantee credited the interest to its county's general fund. After disputing the auditors' findings on the amount of interest earned, the grantee agreed to remit $40,000 as the interest earned on federal funds.

FEDERAL FUNDS IN EXCESS OF CURRENT NEEDS AND INTEREST EARNED THEREON SHOULD BE RETURNED

The DOT Inspector General found that under an UMTA grant, a grantee earned interest on retained funds which were returned to it by a third party upon the settlement of a contract dispute. According to federal cash management requirements, these funds, if not authorized for use in meeting immediate current expenses, should be returned to the federal government. UMTA, however, has not required the grantee to return the funds.

Under the grant, the Massachusetts Bay Transit Authority (MBTA) bought light rail vehicles which later proved defective. MBTA considered legal action but eventually agreed to a cash settlement of nearly $35 million. With approval of UMTA program officials, MBTA retained the cash and invested it with the intent of buying replacement light rail vehicles which, according to MBTA officials, would take about 8 years. UMTA and MBTA agreed that the cash would be held in escrow with interest earned to be applied to the project.

The Inspector General's auditors, citing a Treasury circular and UMTA cash management requirements which state that cash balances should not exceed what is needed for 7 days, concluded that the funds were in excess of the grantee's needs and recommended that the federal share, amounting to about $23 million, be returned to UMTA. The auditors noted that MBTA, through April 1982, would have earned $7.2 million in interest[3] on the federal share of the cash settlement.

The auditors also noted that MBTA was classified as an instrumentality of the state, and as such, was not being required to return the interest earned pursuant to the provisions in the Intergovernmental Cooperation Act which exempts

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[3]MBTA more recently estimated that $20.2 million in interest was earned through September 1983.

states and their instrumentalities from accountability for interest earned on advanced federal funds pending disbursement for program purposes. However, the auditors did not believe that the Intergovernmental Cooperation Act's provision of non-accountability was intended to apply to a situation such as this.

We also believe that the funds are clearly in excess of MBTA's immediate needs and that UMTA should require MBTA to return the funds. In addition, in our view, the interest earned on these funds is not subject to the Intergovernmental Cooperation Act's provision of nonaccountability. The funds held by MBTA are not "pending disbursement" in the sense intended by the Congress in the Intergovernmental Cooperation Act because they are in excess of MBTA's immediate needs, and the funds were received as a settlement from the contractor, not directly from UMTA, the grantor agency. Therefore, the interest earned on the funds should be returned by MBTA.

## RECOMMENDATIONS TO THE SECRETARY OF TRANSPORTATION

We recommend that you direct

--UMTA and FHWA to establish regulations on program income that are consistent with the OMB standards.

--UMTA, FHWA, and FAA to specify in their grant agreements which program income option grantees should use and, when the deductive option is to apply, to specify that grant budgets should not be allowed to increase merely because unexpected program income was generated.

--UMTA, FHWA, and FAA to require grantees to report on the source, amount, and disposition of all types of grant-related income.

--UMTA, FHWA, and FAA to require grantees to pay the federal government its share of property sales proceeds.

--UMTA, FHWA, and FAA to require grantees to return interest earned on (1) sales proceeds when the proceeds themselves are required to be returned and (2) federal funds advanced to nonstate agencies.

--UMTA to determine the Massachusetts Bay Transit Authority's current need for the funds provided for light rail vehicles and seek the return of the federal share of the excess funds being held and interest earned thereon.

## AGENCY COMMENTS AND OUR EVALUATION

DOT generally agreed with the findings and recommendations in this report and said it has placed a high priority on

upgrading its grant and financial management practices. (See app. III.) DOT disagreed, however, with our statements that FHWA has not adopted OMB standards or issued regulations on program income and with our recommendation that UMTA seek the return of excess funds being held by MBTA.

DOT stated that FWHA's regulations and procedures are clearly in compliance with the OMB standards and recommended that we revise our report. We have not revised the report for two reasons. First, FHWA's regulations do not mirror OMB's property management standards (A-102, Attachment N), nor do they address other program income (A-102, Attachment E). Second, DOT's assertion that FHWA has policies and procedures which reflect the application of the deductive option was not borne out by our review.

OMB's property management standards provide that when property is sold, grantees are to **pay** the federal government an amount computed by applying the federal percentage of participation in the cost of the original project to the proceeds from sale. We understand that OMB regards this provision as requiring actual payment by the grantee to the grantor agency. FHWA, on the other hand, allows grantees to credit federal funds at the same pro rata share as federal funds used in the cost of acquisition. A credit could, but does not necessarily, have the same effect as would a payment to FHWA. For example, a credit could result in an augmentation of an agency's appropriation whereas a payment would not if, as is generally required, it is deposited into miscellaneous receipts of the Treasury. Thus, to conform with OMB standards, we believe that FHWA regulations should require the return of cash rather than crediting the federal project account.

In a related comment, DOT also noted that in some cases, UMTA has allowed sales proceeds to be deducted from the capital cost of a new grant, with the federal share computed on the basis of the reduced amount. Like FHWA's procedures, UMTA's practice is inconsistent with the OMB standard which requires actual payment by grantees.

With regard to other program income, OMB's standards provide that grantees should retain the income and, in accordance with their grant agreements, use it under either the additive, deductive, or cost-sharing option. FHWA has not specified how program income should be used and, as noted on pages 3 and 4, the states of Washington and New York deposited program income in their motor vehicle and general funds, respectively, rather than retaining the income in the projects which generated it.

DOT commented that FHWA requires grantees to credit income to the projects to determine the net cost of the project prior to determining the federal share and, in the case of New York and Washington, the funds were properly credited to the respective projects. DOT equates this to the application of

the deductive option available under OMB's program income standards. Based on our review, the funds were not credited to the projects, but were subtracted from the grantees' overall requests for federal program funds. In our opinion, this is merely the application of a financial reporting standard contained in Attachment H of OMB Circular A-102 which requires grantees to subtract certain types of program income from their drawdowns of federal funds.

This subtraction requirement applies regardless of the program income option used. And when applied under the deductive option, the subtraction would also serve to reduce the total federal funds available to grantees. DOT noted, however, that highway construction funds are of an entitlement nature and are apportioned in accordance with statutory formulas. Operationally, this means that grantees can receive the full amount of their entitlements and also retain the program income even though, on a particular drawdown request, some program income is subtracted to momentarily reduce the amount of federal funds provided to grantees for use on a particular project. If grantees receive their full entitlements, and also retain the program income, then there is no reduction of the federal share of total project costs--the objective of the deductive option. In actuality, FHWA's practice is the application of the additive or cost-sharing option, depending on how the grantees ultimately dispose of the program income.

DOT also disagreed with our proposal that UMTA recover from MBTA the federal share of funds held by MBTA from a contract settlement. DOT stated that its decision to allow MBTA to retain the funds was reviewed by its Office of General Counsel and supported in law. DOT added, however, that UMTA has moved to clarify grantees' responsibilities in other similar situations, that the MBTA situation is not viewed by UMTA as precedent-setting, and that future situations will be treated in a manner more in line with that of regular grant funds or program income.

Several issues were discussed in the General Counsel's review of the MBTA case, one of which was the consequence of UMTA requiring the grantee to return the funds. The General Counsel, citing the provisions of 31 U.S.C. 3302, concluded that if UMTA recouped a portion of the settlement, the funds would have to be deobligated and deposited into miscellaneous receipts of the Treasury, and would no longer be available for obligation to MBTA by UMTA. In our view, return of the funds to UMTA would not require that the funds be deobligated. Rather, the funds would continue to be recorded as obligations for the MBTA project, to be transferred to MBTA as needed for disbursement for program purposes. This would enable UMTA to fulfill its obligation to MBTA and at the same time comply with its cash management regulations and the Intergovernmental Cooperation Act's provision that federal agencies minimize the

time elapsing between federal advances and grantee disbursements. Treasury fiscal requirements provide the necessary information as to how UMTA should account for the returned funds.

We also proposed that UMTA recover the interest on the principal amount because it was our view that the funds could not be considered as "pending disbursement for program purposes" as provided for in the Intergovernmental Cooperation Act. As a result, the act's nonaccountability provision does not apply. DOT did not address the issue of whether MBTA should be required to return the interest earned but noted that MBTA qualifies as a state instrumentality to which the Intergovernmental Cooperation Act applies.

DOT also suggested that we define the term "pending disbursement." This term is used in section 203 of the act and we believe that its meaning is reasonably clear in most cases. For example, funds unused after completion of a grant, or funds recovered by a state which it is required to return to the federal government, would not be held pending disbursement for program purposes. However, if more specific definition of the term is thought necessary, we believe that the issue would be more appropriately addressed by OMB which has promulgated guidance on section 203 and by the Treasury Department which has promulgated regulations regarding advances of funds to grantees. In a separate report[4], we recommended that OMB develop standards for several of the interest earning situations discussed in this report and in our report to OMB.

DOT also sought clarification on some of our recommendations. First, with regard to the reporting of income, the use of income, and the return of interest, DOT commented that our findings concerned only UMTA and FHWA, but our recommendations were directed to all four operating administrations. DOT proposed that we either provide support regarding the applicability of the recommendations to FRA and FAA or limit them to UMTA and FHWA. On the basis of subsequent information provided to us by FRA, we deleted FRA from these recommendations because its regulations and standard grant agreement sufficiently address the three issues.

With regard to FAA, however, its regulations do not sufficiently address these issues. FAA requires the reporting of program income but does not require the reporting of other

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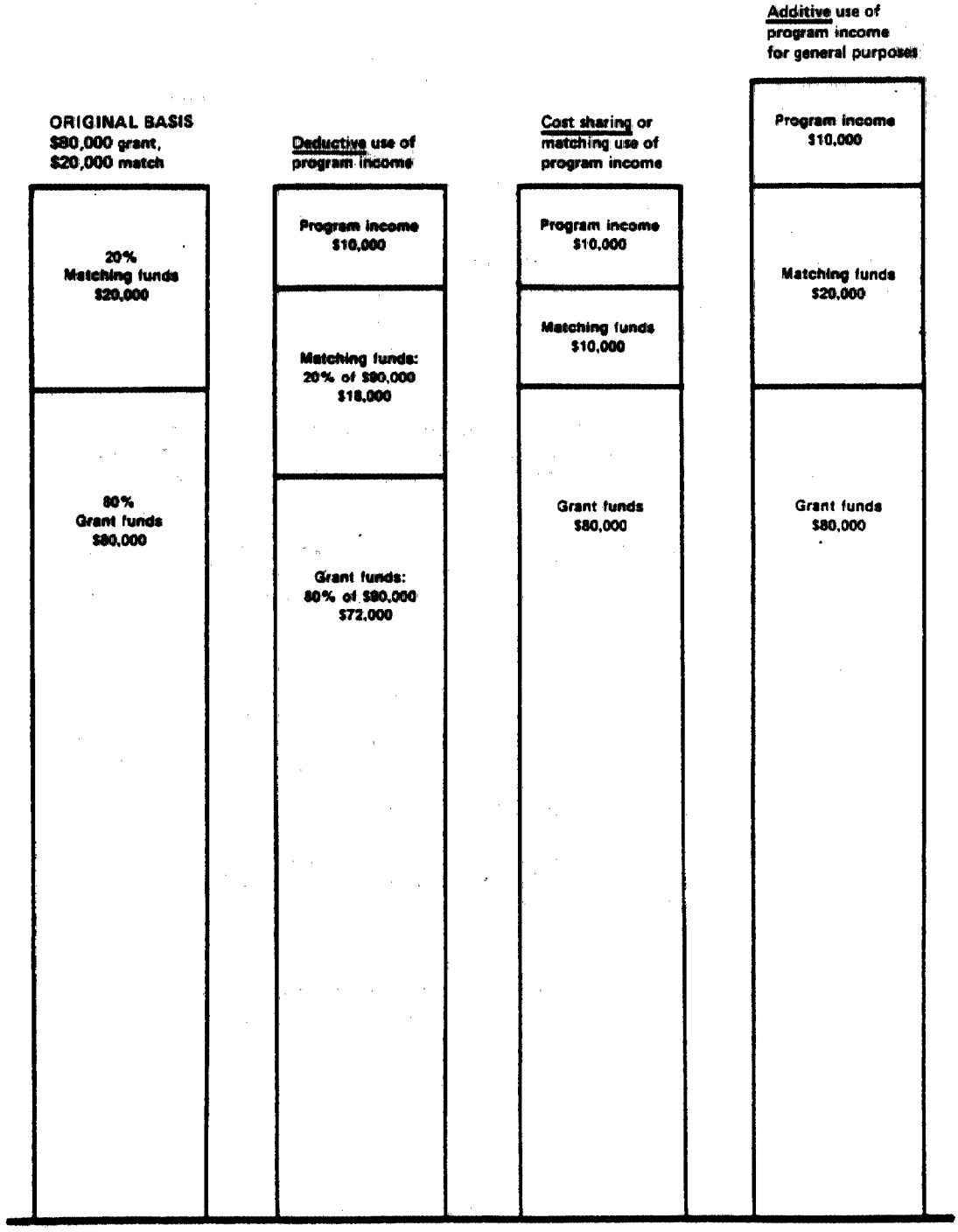
[4]"Improved Standards Needed For Managing And Reporting Income Generated Under Federal Assistance Programs" (GAO/GGD-83-55, July 22, 1983).

types of grant-related income such as sales proceeds and interest. Also, only one of the six FAA grant agreements we reviewed specified which program income option the grantee was to use. Finally, FAA does not have regulations on the disposition of the several types of interest discussed in the report. Thus, we believe our recommendations are applicable to not only UMTA and FHWA, but also to FAA.

DOT also asked for clarification on our recommendation that the DOT operating administrations should require grantees to return interest earned on (1) federal funds advanced to nonstate agencies and (2) sales proceeds when the proceeds are required to be returned. DOT suggests that we specify whether we intend that the operating administrations collect refunds of interest earned in the past as well as in the future. With regard to interest earned in the past, a requirement that such interest be collected in all cases may impose a severe administrative burden on the operating administrations, and in some cases, collection of past interest may be barred by statutes of limitation. Accordingly, we believe that the decision to require refunds of past interest in a given case should be made at the discretion of the operating administrations. At a minimum, however, the operating administrations should revise their current practices to require refunds of interest earned in the future on the types of funds we list in our report.

APPENDIX II

# USE OF PROGRAM INCOME




Source: Department of Health and Human Services

APPENDIX III

U.S. Department of Transportation

Assistant Secretary for Administration

400 Seventh St., S.W. Washington, D.C. 20590

JUN 6 1983

Mr. Oliver W. Krueger
Associate Director, Resources, Community and Economic Development Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Krueger:

This is in response to your letter requesting Department of Transportation (DOT) comments on the General Accounting Office (GAO) draft report, "Transportation Should Improve Its Policies and Practices on Grant Related Income," dated April 21, 1983.

The Department generally agrees with the findings and recommendations of the report, and has placed a high priority on upgrading its grant and financial management practices as part of the Administration's emphasis in this area.

The report, however, suggests some inconsistencies with Office of Management and Budget (OMB) standards on grant related income which we do not believe exist in our programs. GAO indicates that the Federal Highway Administration (FHWA), for instance, has not adopted OMB standards on program income. We believe FHWA regulations on program income, which allow crediting the Federal project account instead of returning cash, are consistent with OMB standards.

Further, the Urban Mass Transportation Administration (UMTA) has developed guidelines over the last few months which will clarify their policies on the subject as part of an overall upgrading of grant and financial management procedures*

We want to emphasize that the Department appreciates the points made in this report and will reflect them in our continuing efforts to upgrade grant and financial management practices across the board.

If we can further assist you, please let us know.

Sincerely,

Karen L. Lee

for Robert L. Fairman

Enclosure

*GAO note: A portion of this paragraph was deleted at DOT's request.

APPENDIX III

Department of Transportation
Statement on General Accounting Office (GAO) Report

I. TITLE: Transportation Should Improve Its Policies and Practices on Grant Related Income

II. Summary of GAO Findings and Recommendations:

The GAO has reviewed Federal agency policies and practices on handling income generated under federally assisted programs. Government-wide guidance for grant-related income is contained in Office of Management and Budget (OMB) Circular A-102, Uniform Administrative Requirements for Grants-in-Aid to State and Local Governments. Specific guidance is contained in Attachment E, Program Income, to OMB Circular A-102. The GAO report noted that:

1. The Federal Highway Administration (FHWA) and Urban Mass Transportation Administration (UMTA) did not have policies in accordance with OMB Circular A-102, and recommended that they establish regulations in accordance with A-102. The report also noted that while UMTA has issued a draft directive implementing one of three possible options for using program income, grant actions of UMTA often achieved results anticipated under another option.

2. Operating administrations need to issue or improve regulations regarding the reporting of project income.

3. UMTA and the Federal Aviation Administration (FAA) grantees had not remitted to the Federal Government the proceeds of sale of property acquired with grant funds. The report also noted that FHWA was advised by its Chief Counsel in 1977 that it should revise its procedures to conform to the A-102 requirement, and had not done so as of March, 1983.

4. Operating administrations have not always taken adequate steps to identify and recover interest earned on Federal funds and sales proceeds. Specifically, UMTA had allowed grantees to use interest accrued for project purposes instead of remitting it to the Federal Government.

5. UMTA has allowed the Massachusetts Bay Transit Authority (MBTA) to retain $23 million from a contract settlement for a rolling stock contract, and to retain all interest earned until MBTA can acquire the rolling stock to complete the project.

The GAO report recommended that the Secretary direct:

1. FHWA and UMTA to establish regulations consistent with OMB standards;

2. UMTA, FHWA, the Federal Railroad Administration (FRA) and FAA to specify in their grant agreements which program income methods to use;

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3. UMTA, FHWA, FRA and FAA to require grantees to report on the source, amount and disposition of program income;

4. UMTA and FAA to enforce regulations on sales proceeds, and FHWA to revise its regulations to require grantees to remit the appropriate share of sales proceeds;

5. UMTA, FHWA, FRA and FAA to require grantees to return interest earned on Federal funds, where applicable; and

6. UMTA to seek the return of the Federal share of excess funds held by MBTA.

III. Summary of the Department of Transportation's Position

The Department generally agrees with the findings and recommendations of the report, with the exception of the recommendation relating to the UMTA grant to MBTA.

IV. Position Statement

1. The Department of Transportation disagrees with the GAO statement that the Federal Highway Administration (FHWA) has not adopted OMB standards or issued regulations on program income. The FHWA regulations on program income are consistent with OMB standards. Attachment E to OMB Circular A-102 states that the proceeds from the sale of real and personal property shall be handled in accordance with Attachment N. This covers most of FHWA's project income. Attachment N states that the grantee may retain title after compensating the Federal Government for its share of the fair market value of the property. The FHWA regulations (23 CFR 713.307(b) state that the disposal of property shall require "a credit to Federal funds at the same pro rata share as Federal funds participated in the cost of acquisition" and that the amount shall be based on current fair market value. FHWA regulation (23 CFR 480.113) which was published in December of 1977 also deals with property disposition.

   Attachment E to OMB A-102 states that other program income may be deducted from the total project costs to determine the net costs on which the Federal share is based. FHWA policies and procedures have, for many years, been based on the principle that any project income must be credited to the project to determine the net cost of the project prior to determining the Federal share. In fact, in the case of the New York and Washington example cited on page 4 and 5 of GAO's report, the funds in questions were properly credited to the respective projects.

   These procedures are clearly in compliance with the OMB standards and we recommend that GAO revise its report accordingly.

   The Federal Highway Administration awards grants to highway agencies with which it has had ongoing relationships for many years. All funds provided to these recipients are of an entitlement

nature and are apportioned in accordance with statutory formulas. To require a grantee to return cash rather than crediting the Federal project account would only create unnecessary red tape for the recipient and FHWA with no other impact. Accordingly, FHWA will continue its current practices.

2. Over the last few months, UMTA has developed comprehensive guidelines on the reporting and disposition of program income which are consistent with OMB guidance. Grantees will be permitted to use the additive or deductive method; however, regional office approval will be required for the use of the additive method. These requirements will be added to grant agreements, and will include requirements for reporting on the source, amount and disposition of grant-related income.

3. UMTA plans to issue program guidance concerning sales proceeds. However, even in the absence of such formal guidelines, UMTA has required grantees to refund a proportional share of sales proceeds to UMTA. UMTA has not always required the refund in the form of cash or credit to the capital grant under which the property was purchased. UMTA has often used the "revenue financing" approach to recover such funds. Under this approach, the sales proceeds are deducted from the capital cost of a new grant, and the Federal share is computed on the basis of the reduced amount. This is analogous to the deductive option for use of program income in A-102, but is used in a subsequent grant rather than used to reduce the amount of the grant under which the property was purchased.

4. UMTA plans to amend program guidance to clarify and reemphasize requirements concerning Federal funds held by grantees.

5. DOT does not plan to take any action with respect to the funds held by MBTA. UMTA's decision has been reviewed by the Office of the General Counsel, and that Office has found UMTA's decision is supported in law. (Please see enclosure.)

   We would like to point out that UMTA made the MBTA decision only after very careful consideration of the unique circumstances of that case. UMTA has taken steps to clarify grantee responsibilities with regard to settlement of contract disputes, and believes that clearer direction by UMTA will preclude similar situations from arising in the future. UMTA does not view the MBTA situation as precedent for disposition of other settlement funds, and will attempt to ensure that future settlement funds are treated in a manner more in line with regular grant funds or program income.

6. The FRA standard grant agreement includes a process consistent with the OMB standards for program income, and requires grantees to report program income. FRA is also currently implementing an Office of Inspector General recommendation regarding the return of interest earned.

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7. Three of the report recommendations regarding the reporting of program income, the use of program income, and the return of interest earned by recipients cite UMTA, FHWA, FRA and FAA requirements. However, the findings of the report only fault UMTA and FHWA requirements. For example, the report noted $1,989,918 and $90,148 of unreported program income for FAA and FRA programs respectively, with examples provided where recipients did not report in accordance with FAA or FRA requirements. The report did not cite missing or inadequate requirements for the nonreporting, and those programs do have requirements for reporting. We recommend that the report be modified to provide support regarding the recommendations to FRA and FAA, or that the recommendations be limited to UMTA and FHWA.

8. On pages 8 and 10 of the report, the GAO uses the term "pending disbursement" as a criteria for determining if interest earned on Federal funds requires remittance to the Federal Government. GAO should define the term "pending disbursement." Currently, there is no clear definition of what "pending disbursement" means. Treasury Circular 1075 and Treasury Fiscal Requirements Manual require all funds over $10,000 be spent within seven days or returned to the Treasury, and funds under $10,000 within 30 days of receipt. However, no one has used these definitions in relation to "pending disbursement."

9. On page 10 of the report, GAO stated that the Inspector General's Auditors cited UMTA cash management requirements. GAO should have said that the Inspector General's auditors cited a Treasury Circular and the UMTA cash management requirements, which state that Federal funds of $10,000 or more which will not be expended within seven days must be returned to UMTA.

10. The GAO should provide a recommendation or be more definitive on the issue of allowing non-State instrumentalities to retain interest. Does GAO only want the administrations to discontinue this practice in the future, or does GAO want the administrations to request refunds of interest earnings in the past? If GAO wants to go back into previous years, there is a question whether the statute of limitations on the time grantees are liable for interest earnings has expired.

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Enclosure

FEB 15 1990

Request for Legal Opinion re
MBTA-Boeing Contract Dispute

Rosalind A. Knapp Original signed by
Deputy General Counsel Rosalind A. Knapp

Joseph P. Welsch
Inspector General

You have requested a resolution of the question as to whether the law requires that the Urban Mass Transportation Administration (UMTA) request from the Massachusetts Bay Transit Authority (MBTA) a refund of a Federal share ($23,143,812) of a contract settlement between MBTA and Boeing Vertol (Boeing). Based upon the facts presented to us by your office and UMTA, we are of the opinion that UMTA has acted in a legally supportable manner by not so requesting a refund.

## FACTS

MBTA had drawn down and disbursed UMTA grant funds to Boeing for the acquisition of light rail vehicles, the purpose for which the funds were granted. Subsequently, MBTA averred that Boeing had violated the contract by delivery of inadequate vehicles. As a result of this contract dispute, MBTA and Boeing reached a settlement under which MBTA was to receive $40 million plus retention of 135 vehicles already delivered under the Boeing contract. UMTA concurred in the settlement provided MBTA put the funds in escrow and use the proceeds and interest for completion of the planned vehicle purchases.

The key facts are: MBTA had drawn down the funds for the purpose for which they were granted; MBTA disbursed the funds to Boeing under a contract to meet that purpose; the funds MBTA has received back from Boeing represent only a return of money paid to Boeing by MBTA for the fulfillment of the contract and no more; and MBTA is to reapply the funds received back from Boeing for the same purpose for which the grant was made.

## THE LAW SUPPORTS UMTA'S ACTION RE THE SETTLEMENT FUNDS

There is no dispute that the UMTA grant to MBTA was properly made. When UMTA makes a grant under the Urban Mass Transportation Act of 1964, as amended (the Act), it is axiomatic that the grantee's realization of the

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purpose for which the grant was made is of paramount importance. (See e.g. section 2(b) of the Act (49 U.S.C. 1601(b)).) There are ways by which the grantee can thwart or distort that purpose by abuse of the grant process. One is when the grantee applies the grant funds to a purpose other than that for which they were granted. Another is when the grantee profits from the grant funds, intentionally or by "windfall," in a way not intended under the original grant. Federal law is well cognizant of these potential abuses, as evidenced by the Comptroller General opinions, Treasury fiscal requirements, Office of Management and Budget policies, and UMTA rules and policies cited by you. For the reasons explained below, MBTA is not guilty of either of these abuses.

That MBTA is to apply the settlement funds to the purpose for which UMTA originally made the grant is also undisputed. It is a condition of UMTA's acquiescence in the settlement.

What is more important is that the settlement funds represent only a return of money MBTA paid to Boeing for fulfillment of the contract and no more. Therefore, MBTA is not realizing a "windfall" profit out of the settlement. This differs significantly from the antitrust settlement situations in the Comptroller General (GAO) decisions you cited. Those cases involve an overcharge by a contractor. GAO therefore considers the recovery by the grantee in those cases to be a reduction in cost and therefore a cost never properly chargeable under the grant. Thus it would be improper for the grantee to retain settlement funds that include an amount attributable to federal funds drawn down under the grant, but not properly chargeable to the grant. The grantee could even use the excess funds for purposes not attributable to the grant. The grantee thus would realize and benefit from a double recovery of the funds, once from the settlement and once from the federal government. (See 57 Comp. Gen. 577 (1978); 47 id. 309 (1967); and B-162539, October 11, 1967.)

Unlike the situation in these cases, MBTA under the Boeing settlement did not recoup an amount in excess of the federal share properly chargeable to the grant plus MBTA's share. Furthermore, MBTA is to reapply the recouped funds solely to the purpose for which the federal share has been granted and drawn down, costs properly chargeable to the grant. GAO implicitly recognized this as proper in one of the antitrust cases when they expressly did not object to the reapplication of the federal share of the settlement to properly allowable charges under the grant. (57 id. 577, at 582.)

In addition, MBTA's retention of the settlement funds without refunding a pro rata share to UMTA is not in violation of section 203 of the Intergovernmental Cooperation Act of 1968 and section 2025 of the Treasury Fiscal Requirements Manual, which you cited. These basically require a grantee to draw down funds as close as administratively possible to the actual need for disbursement. Actually, these sections do not even apply. What they are intended to preclude is intentional, premature drawing down

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by grantees so that they may realize an additional, non-grant sanctioned benefit from the funds before disbursement for the purposes for which they were granted, thus profiting at the federal government's expense. MBTA properly drew down the funds and disbursed them in a timely manner. MBTA's recovery under the settlement is not a drawing down, and certainly MBTA could not have intended a contract dispute and resulting settlement from which they could "profit" through the funds drawn down. This differs materially from the decisions in which GAO finds violation of the Treasury requirement. (See 56 Comp. Gen. 353 (1977) where the grantee drew down the funds with the intent to create an endowment not authorized under the grant and thereby profit by delayed disbursement for grant purposes.)

As we understand the facts, the result of MBTA's and UMTA's actions actually appear to be consistent with the primary intent of the Intergovernmental Cooperation Act and the Treasury requirements for grants and UMTA's grant authority. That primary intent is the realization of the purposes for which Congress appropriated the money and authorized the grant. If UMTA were to recoup a portion of the Boeing settlement money, that purpose would be frustrated. It would create an impractical and injudicious situation for both the federal government and MBTA. The appropriations upon which the 1973 MBTA grant was made have lapsed and are no longer available for deobligation and reobligation. If UMTA were to recoup a portion of the settlement, it would have to be deposited into the miscellaneous receipts account in the Treasury and would no longer be available for obligation to MBTA by UMTA. (See 31 U.S.C. 484.) Therefore, completion of the MBTA project for which the funds were appropriated would require use of subsequent funding from Congress and, with inflation, possibly larger amounts. As it is, MBTA retains the funds, applies them to the purpose for which they were appropriated and granted and largely makes up the difference by the interest earned on those funds.

As to MBTA's retention of the interest, we have twice ruled that MBTA is a State agency legally allowed to retain the interest under section 203 of the Intergovernmental Cooperation Act of 1968 (42 U.S.C. 4213). (See the May 19, 1981, memo to your Director of Regional Programs and the June 23, 1982, memo to your Assistant Inspector General for Auditing.)

## UMTA'S POST SETTLEMENT ADVANCE

After the settlement, MBTA drew down $3,143,856 for payment to Boeing for the amount due on cars already delivered by Boeing and retained by MBTA under the contract pursuant to the UMTA grant. This particular cost was not disputed under the contract dispute between MBTA and Boeing nor was it included in the settlement amount. The settlement amount represents return of the amount necessary for the completion of MBTA's and UMTA's grant agreement. The full $3,143,856 plus MBTA's share has been disbursed to Boeing. Accordingly, we do not see that any of the legal issues you raised are germane to this draw down.

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## CONCLUSION

We must conclude that UMTA has acted in a legally supportable manner in the MBTA-Boeing contract settlement matter. We do see from this situation that there are potential areas for tightening UMTA's administration of its grants to at least help avoid some of the confusion and ad hoc nature of situations such as the MBTA-Boeing settlement. One possibility is to consider inclusion of clauses in the basic grant agreement that would explicity provide for contingencies such as a contract dispute. Potential areas to address are requiring grantee advance notification to UMTA of potential contract disputes and UMTA concurrence in settlements between a grantee and a contractor and standards for establishing the timing and manner of accomplishing the remaining, unaccomplished purposes of the grant. In considering what prospective measures such as these may be used in the future, UMTA should strongly consider and use as the primary basis the fiscal interests of the federal government.

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