Interest Earned on Advances/Program Income

April 12, 1991

MEMORANDUM FOR: John W. Peters, Regional Director, CPD, 10C

FROM: Russell K. Paul, Deputy Assistant Secretary for
Grant Programs, CG

SUBJECT: Request for Determination: Interest Earned on Advances/Program Income

This is in response to your memorandum dated December 7, 1990, concerning an audit finding on the use of program income. The finding was included in a report on an audit of the City of Tacoma, Washington.

As we understand the facts, the City deposited Community Development Block Grant (CDBG) program income in an EDA Title IX revolving loan fund. These funds were deposited as matching funds for an EDA project. The revolving loan fund was a "revolving fund," as defined at 24 CFR 570.500(b).

According to information furnished to us orally by your staff, the revolving fund was inactive for approximately two years prior to the issuance of the audit report. Subsequent to the issuance of the audit report, the City used the program income in the revolving fund to carry out activities of the nature that the revolving fund was established to undertake. While the program income was held in the revolving fund, the City withdrew the grant funds from the U.S. Treasury for other CDBG activities.

You have indicated in your memorandum that you agree with the Regional Inspector General for Audit (RIGA) that the program income should have been disbursed prior to the City's having made any withdrawal of grant funds from the U.S. Treasury. You have disagreed, however, with the RIGA's recommendation that the City be required to remit to HUD interest earned on the program income pending its use.

If our understanding of the facts is correct, insufficient basis exists for concluding that the City violated the requirements governing the use of program income. Section 570.504(b)(2)(i) of the CDBG regulations require that program income in a revolving fund be substantially disbursed prior to the recipient's making grant withdrawals from the U.S. Treasury for the "same activity" (i.e., the activity that the revolving fund was established to undertake). It does not require program income in a revolving loan fund to be disbursed prior to the grant withdrawals for other CDBG activities.

Although the City has failed to use the program income in the revolving fund for an extended period, it was never notified that the revolving fund was insufficiently active. In addition, we have never issued standards for evaluating whether the level of activity is so low as to disqualify the program income held in a revolving fund for the special treatment under Section 570.504(b)(2)(i). In the absence of such notification or established standards, requiring the interest on the program income to be remitted to HUD based on a finding of a violation would be arbitrary.

If no violation occurred, the issue of whether the RIGA's recommendation could or should be implemented is moot. However, since the information provided to us orally by your staff was obtained from the City and has not been confirmed, we will address the RIGA's recommendation.

Apparently, the RIGA has recommended that interest earned on the program income pending its use be remitted to HUD. In addition, the RIGA has recommended that the amount remitted be sufficient to make the U.S. Treasury "whole" for the additional interest expense it incurred by disbursing funds earlier than it would otherwise had the program income been used first. This would mean that if the interest earned from the investment of the program income is less than the interest expense incurred by the U.S. Treasury in financing the grant payments to the City while the program income was held in the revolving fund, the difference would also be remitted.

Your memorandum to us notes correctly that no specific authority exists to require either category of interest to be remitted to HUD. The RIGA has cited provisions in U.S. Treasury's regulations at 31 CFR Part 205 that it contends provides such authority. Under these provisions, HUD is responsible for reviewing the practices of recipient organizations and instituting remedial measures if such organizations fail to comply with U.S. Treasury requirements on cash withdrawals.

The provisions of the U.S. Treasury's regulations cited by the RIGA do not provide a basis for requiring interest on the program income to be remitted to HUD. First, HUD has fulfilled the responsibilities imposed on it by these regulations, insofar as the CDBG program is concerned. Review of CDBG recipients' compliance with U.S. Treasury regulations governing cash withdrawals is an integral element of our financial management monitoring under the CDBG program. Further, our regulations authorize remedial actions in response to violations of the U.S. Treasury's requirements, including changing the method of payment to a reimbursement basis.

Second, and more important, the U.S. Treasury's regulations do not require that program income be disbursed before additional grant funds are withdrawn. That requirement is contained in the HUD regulations cited above. Although disbursing program income first is consistent with the spirit of the U.S. Treasury requirements, these requirements could not be used as a basis for implementing remedial actions as the RIGA suggests.

We do not find any other basis for requiring a recipient to remit either interest earned on program income or an amount to compensate the U.S. Treasury for additional interest expenses incurred as a result of failure to comply with the HUD requirements on using program income. Although no such requirement exists, it would be possible, pursuant to Section 570.910(b)(2), to recommend to the City that it remit to HUD interest on the program income.

However, if the City failed to follow that recommendation, the only alternative available under the CDBG regulations would be to institute an action under Section 570.913. Even assuming that it can be established that the City failed to comply substantially with the governing requirements, none of the remedies that are available to HUD under Section 570.913(a) would compensate the Treasury for any additional interest expense on its part. Although HUD could refer the matter to the Attorney General with a recommendation that a civil action be instituted, the amount of interest at issue here would not justify the expense of such an action.

Based on the foregoing, we do not recommend any further action on this matter by the Field Office. You may, however, advise the RIGA that we intend to propose regulations that will require program income in a revolving fund to be disbursed prior to making any grant withdrawals from the recipient's line of credit with HUD. That is, we will propose elimination of the special treatment now authorized for program income in a revolving fund. Elimination of this special treatment is the most effective way to address the legitimate concern raised by the RIGA.

cc: Edwin Gardner, SC