BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Director, Office Of Management And Budget

Improved Standards Needed For Managing And Reporting Income Generated Under Federal Assistance Programs

Office of Management and Budget circulars provide useful Government-wide guidance and standards for managing and reporting income generated under federally assisted programs. However, additional standards are needed for some grant related income issues and some existing standards need to be clarified.

GAO is recommending improvements to these standards to better ensure that income generated under federally assisted programs is applied toward accomplishing grant related income objectives of using the income to increase the size of federally assisted programs or to reduce the Federal Government's and grantees' shares of program costs.

GAO/GGD-83-55

JULY 22, 1983

Request for copies of GAO reports should be sent to:

U.S. General Accounting Office
Document Handling and Information
Services Facility
P.O. Box 6015
Gaithersburg, Md. 20760

Telephone (202) 275-6241

The first five copies of individual reports are free of charge. Additional copies of bound audit reports are $3.25 each. Additional copies of unbound report (i.e., letter reports) and most other publications are $1.00 each. There will be a 25% discount on all orders for 100 or more copies mailed to a single address. Sales orders must be prepaid on a cash, check, or money order basis. Check should be made out to the "Superintendent of Documents".

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

GENERAL GOVERNMENT
DIVISION

B-202774

The Honorable David A. Stockman
Director, Office of Management
and Budget

Dear Mr. Stockman:

This report contains the results of our Government-wide review 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 had not established regulations conforming to the Office of Management and Budget's (OMB) grant related income standards and/or were not adequately implementing their grant related income regulations. We also found that the OMB standards do not address all grant related income issues and that the income reporting requirements are not clear. 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. A detailed discussion on the results of our review is presented in Appendix I.

We are recommending that you establish additional standards on some income issues and clarify the standards on others. These recommendations appear on pages 23 and 24. 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 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 more than 60 days after the date of the report.

We are sending copies of this report to 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 FEDERAL ASSISTANCE PROGRAMS

BACKGROUND

Grant-related income is any money received by grantees during the course of operating federally assisted programs. Grant-related income may be generated by grantees from (1) fees charged for providing health care, adult vocational education, and social services; (2) rents for land, housing, and industrial facilities collected on properties acquired with Federal assistance; (3) investment income (interest) earned on grant project funds; (4) proceeds realized from the sale of commodities, property, and equipment; and (5) royalties accrued from the use of patents and copyrights.

In an effort to establish consistency and uniformity among Federal agencies in the administration of grants to State and local governments and nonprofit organizations, OMB promulgated grant administration standards through Circulars A-102 and A-110.[1] Standards for grant-related income were issued as Attachment E in OMB Circular A-102 and as Attachment D in OMB Circular A-110. The provisions of the State and local government and the nonprofit organization attachments are identical except for the accounting requirements imposed on State and local governments for certain types of revenues generated under their taxing authorities.

Basically, the circulars' attachments provide that Federal agencies shall apply the grant related income standards to grantees by requiring them to account for income generated under projects financed in whole or in part with Federal grant funds. OMB categorized different types of income by source and provided standards for each type's disposition, as follows:

--Interest earned by States or their instrumentalities and by tribal organizations on advances of Federal funds need not be remitted to Federal agencies per the provisions of the Intergovernmental Cooperation Act of 1968 and the Indian Self Determination Act.

---

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

--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.

--Royalties from copyrights or patents produced under grant supported activities belong to grantees unless grant agreements provide otherwise.

--Revenues received by State and local governments under their taxing authorities (taxes, special assessments, levies, fines, etc.) and the expenditure thereof must be recorded as part of the grant and used for project purposes when grant agreements so specify.

--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.

The circulars offer three 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 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 non-Federal 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.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our review was undertaken to assess Federal policy for reporting and disposing of grant-related income.

Federal financial assistance is provided to State and local governments through about 500 programs. Because existing information and reporting systems are inadequate for determining the number of programs generating income and the amount collected, we selected 61 Federal assistance programs operated by 11 agencies on the basis of our knowledge of Federal programs, the likelihood that income could be generated given the nature of the programs, and our discussions with Federal officials. We examined financial reports in Washington, D.C., and Federal field offices and also Federal agencies' audit reports for these 61 programs and found that grant-related income was reported for 41 programs. Of the 41 programs, 12 were converted into block grants; however, because of fewer Federal regulations and more State administrative responsibilities, we eliminated these 12 programs from our review.

Of the remaining 29 programs, we selected 18 for review on the basis of their ability to provide multi-agency coverage and to generate different types of grant-related income such as fees for services, rental income, income from the sale of real and personal property, and interest income. We considered this type of program selection necessary to demonstrate that any problems involving income were more than isolated occurrences.

The number of State visits and grantee/subgrantee contacts, by program, are shown below.

Program	Number of States visited	Number of grantees/ subgrantees contacted
Community Health Centers	8	9
Migrant Health Centers	7	8
Head Start	1	2
Runaway Youth	3	4
Aging Nutrition	4	12
Aging - Title III A&B	4	12
Wildlife Restoration	10	10
Fish Restoration	10	10
Outdoor Recreation	6	9
Historic Preservation	5	12
Federal Aid Highways	2	2
Airport Development Aid Program	5	9
Mass Transit Capital Improvement	5	6
Local Rail Service	3	7
Vocational Education - Basic Grants	3	8
CETA	4	8
Juvenile Justice And Delinquency Prevention-Formula Grants	5	11
Juvenile Justice and Delinquency Prevention-Special Emphasis Grants	3	8

In total, we made 147 grantee/subgrantee contacts in 12 States.

Our intent was to review a few grantees/subgrantees under a large number of programs in multiple locations to gain a systematic rather than localized view of grantor and recipient policies and practices. While a particular program, by its nature, may be susceptible to generating income, not all grantees would generate income. Thus, for 16 programs, we decided to review grantees in at least three States to compare Federal agency and grantee policies and practices. For the remaining two programs, we visited one or two States and reviewed fewer grantees because of prior audit coverage in the highway program and because the Head Start program was not, statutorily, considered susceptible to program income. Our selection of the grantees 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.

We interviewed Washington, D.C., headquarters officials of the Office of Management and Budget and the Departments of Health and Human Services (HHS), the Interior, Transportation (DOT), Labor, Education, and Justice and examined their records. Interviews and record examinations were also conducted in four Federal regions--New York, Atlanta, Denver, and Seattle. We interviewed officials having program, grant administration, accounting, budgeting, auditing, and legal responsibilities. We also reviewed several hundred internal audit and Inspector General reports of these agencies and used these reports, along with data we collected, to develop our findings. We conducted these interviews and record reviews to ascertain Federal policies on grant-related income and to determine whether agency and grantee practices were in accord with these policies.

Where readily available, we compiled the amount of income (1) reported by grantees to the Federal agencies and (2) not reported to the Federal agencies but disclosed in audit reports.

Our review was performed in accordance with generally accepted government auditing standards.

A CLEARER AND MORE INCLUSIVE FEDERAL POLICY IS NEEDED ON GRANT-RELATED INCOME

The issuance of standards by OMB in 1971 for State and local governments and in 1976 for nonprofit organizations marked a major Federal policy decision to elevate the subject of grant-related income from an individual Federal agency approach to a uniform, Government-wide approach and in this respect, the standards have been very helpful. However, a number of grant related income issues are not clearly or completely addressed by the standards. The result has been that the Federal and grantee interests in grant-related income have not been clearly or completely delineated.

Standards are needed on the (1) spending of income as to time and purpose, (2) classification of oil, gas, and mineral income, and (3) disposition of several types of interest income.

Standards needed for program income expenditures

OMB's standards specify that program income earned during the grant period shall be retained by the grantee but do not provide guidance on when the income should be spent and what costs program income may defray. The question of when program income should be spent is relevant from a cash management

standpoint. That is, grantees' use of program income as it is received to defray project expenses benefits the Federal Government by reducing Federal fund advances and associated borrowing costs. The question of what costs program income may defray is relevant because agencies answer it differently although it appears to us that existing Federal cost allowability standards suggest that program income be treated like other project funds. OMB standards addressing these questions could promote the overall goal of uniformity envisioned by the circulars themselves as well as Federal cash management and cost allowability objectives.

When should program income be spent?

Agencies' policies and grantees' practices provide different answers to this question. We found that some grantees use the income for current expenses and reduce their requests for Federal funds by the amount of program income received. Other grantees, however, either in response to agency direction or lack thereof, retain and plan to spend the income after or later in the project period; and, thus, they do not reflect program income in their drawdowns of Federal funds. In addition to the cash management implications of the latter practice, it may be difficult for Federal agencies to ensure that program income retained for expenditure after the project period will be used for originally agreed upon purposes.

Both HHS and the Department of Education have department-wide regulations on grantees' spending of income as to time, but these regulations vary with the program income option used. For grants under the additive option, the regulations allow grantees to use program income after Federal support ends. Under the deductive and cost-sharing options, however, grantees are required to use income for current costs unless the granting agency authorizes deferral. HHS' Administration on Aging, however, does not distinguish by option. It requires grantees to spend program income funds before spending Federal grant funds.

The Interior's Wildlife Restoration Program was among the programs we reviewed which had no regulations on when program income should be spent. Under this program, States such as Florida and Georgia earned substantial income from the sale of special hunting permits and wildlife management area stamps and plan to spend it in the ensuing years. In Florida, annual permit sale revenues totaled over $1 million in 1981 and, after deducting for certain expenses, were deposited to a land acquisition trust fund. This fund totaled $1.7 million as of June 30, 1981. Also, Florida received $1 million in 1981 as a lump-sum payment under a 45-year lease agreement where 884 acres of a federally assisted wildlife management area were

leased to a city for waste treatment purposes. The money was placed in a special trust account for future development of wildlife management areas.

In Georgia, income from hunting stamp sales is remitted to the State Treasury. Income in fiscal year 1980 was about $320,000. These funds are appropriated by the State for wildlife purposes in the following year.

Agencies' policies, and in particular the lack thereof, are important when viewed in the context of Federal cash management objectives. Reduced Federal borrowing costs by virtue of reduced Federal fund advances or reimbursements could result if grantees were required to use program income as it is received to defray project costs before requesting Federal funds. Although not explicit, this appears to be the objective sought by Attachment H of OMB Circular A-102 which requires grantees to subtract program income from their requests for Federal funds. However, in the Florida and Georgia examples cited above, the program income was not subtracted from requests for Federal funds. And as discussed on page 21, this requirement appears to apply only under the additive option. A standard calling for the spending of program income before spending Federal funds would ensure that the income is spent during the time the project is active and on project purposes and would result in a reduction of grantees' immediate needs for Federal funds.

What can program income be used for?

As was the case with the question of when program income should be spent, the answer to the question of what it can be spent for is different depending on the program involved. Some agencies' regulations subject program income to the same rules applying to the uses of Federal funds, but others allow the income to be spent on project costs not otherwise eligible for Federal reimbursement. Still other agencies had no regulations. Thus, grantees have used program income funds for a variety of costs that may or may not benefit program objectives.

HHS and Education have department-wide regulations on spending income as to allowability but they vary depending upon the program income options used. Under the additive option, grantees may use program income to pay for costs that are not otherwise allowable as charges to grants as long as the incurred costs further the broad objectives of the program. But those grantees who are required to use the deductive or cost-sharing options may only use program income funds for costs that are allowable as charges to grants.

Interior's wildlife program policies consider program income as Federal funds and subject them to the same standards of cost allowability. Interior's Outdoor Recreation Program regulations state that program income funds should be used for furthering outdoor recreation purposes but do not specify whether the income is subject to the same cost allowability standards as grant funds.

OMB, in its Circulars A-87 and A-122 establishing cost principles applicable to grants with State and local governments and nonprofit organizations, respectively, states that grant program funds can be used only for allowable costs. OMB defines grant program as an activity funded by Federal and grantee funds. In a report[2] on grants awarded to certain nonprofit organizations, we stated that a grant program is comprised of not only the Federal and grantee funds but also any program income generated under the program. Thus, in our opinion, program income funds could be used only for allowable costs.

Our determination, however, applies only to the case we examined in the report. We believe it would be desirable for OMB, in view of the differing agency policies and the uniformity sought by its circulars, to establish a standard which states whether or not program income funds are subject to the same cost allowability standards as project funds.

Guidance needed for classifying proceeds from sale of oil, gas, and other minerals

A standard is needed to guide Federal agencies and grantees on the disposition of proceeds from the sale of products of land acquired in whole or in part with Federal assistance. We found that proceeds from selling timber, gravel, oil, natural gas, and other minerals were being classified as program income by some Federal agencies and as sales proceeds by others. When the proceeds are classified as program income, grantees are allowed to keep the income and use it according to the specified program income option. When classified as sales proceeds, grantees must generally remit the income to the Federal agencies.

The grant related income standards in the OMB circulars do not state whether these types of income are program income or sales proceeds. OMB defines real property as land and land improvements, structures, and appurtenances thereto. Program

---

[2]"Restrictions on Abortion and Lobbying Activities in Family Planning Programs Need Clarification" (GAO/HRD-82-106, Sept. 24, 1982.)

income is defined to include the sale of commodities. However, there is no clear indication as to how oil, gas, and other minerals should be classified. An OMB official responsible for the circular told us that the question never came up and therefore, no OMB guidance exists on the issue.

Lacking specific guidance, agencies have classified these types of income differently. A DOT audit report disclosed that a Federal Aviation Administration (FAA) grantee in Sacramento County, California, funded under the Airport Development Aid Program, had generated over $580,000 of income from the sale of natural gas and had not reported the income to FAA. In the audit report, the income was considered as program income.

Our review showed that several grantees funded under Interior's Outdoor Recreation Program and Fish and Wildlife Restoration Programs were generating substantial amounts of grant-related income from the sale of oil and natural gas. We asked attorneys in the Interior Department's Solicitor's Office about the disposition of the income. They stated that in the Outdoor Recreation Program, a statutory provision provides that the income be added to the projects involved and that in the Fish and Wildlife Programs, their interpretation of agency regulations was that income must be added to the projects. For Interior programs in which statutory or regulatory provisions do not address the issue, it was their contention that grantees earning income from the sale of oil, natural gas, and other products of the land would be required to handle the income in accordance with the sales proceeds standards and thus remit the Federal share of the sales proceeds to the Government.

Statutory or regulatory provisions direct the disposition of this type of grant-related income in only a few of the programs we reviewed. For the other programs, agencies have not addressed the issue or, as noted above, have addressed it on an ad-hoc basis. The differing treatments are an issue only if OMB continues to view uniformity as important. As a minimum, however, we believe that proceeds from the sale of mineral deposits, like other forms of grant-related income, should be addressed by OMB's standards.

Standards should provide for disposition of interest earned by grantees

During our review we identified five ways in which grantees earn interest through their participation in Federal programs. OMB standards and Federal agencies' regulations generally address only two of the five. For the other three types, grantees are earning interest on program income, sales

proceeds, and Federal funds not pending disbursement for program purposes; however, the disposition of this interest is not guided by Federal standards. In our opinion, Federal standards should guide the disposition of interest as is currently the case with the disposition of the principal amounts on which it is earned.

The five types of interest earning situations and the existing OMB standards are listed below.

Interest earned on	OMB standards on disposition
Federal funds held by States and State instrumentalities that are pending disbursement for program purposes.	States and instrumentalities are not held accountable for interest earned.
Federal funds held by non-State entities.	Non-State entities must return to the Federal Government any interest earned on Federal funds.
Proceeds from the sale of real or personal property.	None
Federal funds held by States, State instrumentalities, and State subgrantees that are not pending disbursement for program purposes.	None
Program income.	None

The two OMB disposition standards are based on Federal statutes. The first stems from the Intergovernmental Cooperation Act of 1968 which exempts States from accounting for interest earned on grant-in-aid funds pending their disbursement for program purposes. The second is based on 31 U.S.C. 3302, Revised, (formerly 31 U.S.C. 484) which states that income received for the Government must be deposited, without deduction, in the Treasury. We have consistently held that this provision applies to interest earned by non-State agencies on advances of Federal funds irrespective of whether they are pending disbursement. It also applies to interest earned by States and their instrumentalities and subgrantees on Federal funds which are not pending disbursement for program purposes.

The disposition of interest earned in the three situations not covered by OMB's standards has been raised or addressed sporadically by Federal agencies, as discussed below.

Interest earned on sales proceeds

The regulations of the six Federal departments we reviewed deal with the disposition of sales proceeds but do not address the disposition of any interest earned on the proceeds. The potential for interest income arises when grantees defer remitting the Federal share of sales proceeds or defer applying the proceeds to program purposes. Although we did not find it to be a widespread occurrence, we believe that the disposition of interest earned on sales proceeds should be guided by a standard like other forms of grant-related income.

The cases we noted involving interest on sales proceeds all relate to DOT's Urban Mass Transportation Administration (UMTA) grantees. In each case UMTA, when apprised of the interest earnings, directed their disposition, although in different ways. For example, during an audit of an UMTA grantee in Colorado, DOT auditors found that the grantee had earned and retained interest on sales proceeds. As recommended in the audit report, UMTA required the grantee to remit $17,154--the Federal share of the interest. But in an audit of a grantee in Tennessee, the auditors recommended and UMTA agreed that interest amounting to $80,172 earned on invested sales proceeds should be credited to the project rather than remitted to UMTA.

We also reviewed an UMTA grantee in Utah who 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 noted that UMTA officials did not raise any question on whether interest was earned. We discussed this with UMTA regional officials, and they said that the Federal share of the interest would be recovered.

Interest earned on Federal funds not pending disbursement

The Intergovernmental Cooperation Act of 1968 (31 U.S.C. 6503) exempts States and their instrumentalities from returning interest earned on grant funds which are pending disbursement for program purposes. The act's nonaccountability provision, however, does not extend to interest earned by States and other grantees which are holding Federal funds that are not awaiting disbursement for program purposes. Interest earned in this situation generally is required to be returned in accordance with the provisions of 31 U.S.C. 3302, Revised. Neither OMB program income standards nor Federal agencies' regulations address the disposition of interest earned under this circumstance.

Our study of the cash management practices of nine States identified about $126 million of Federal funds that were owed to the Federal Government but were not immediately returned. We estimated that about $15 million of interest was earned on these funds. In our opinion these funds were not being held pending disbursement for program purposes, and, therefore, the 1968 act's nonaccountability provision would not be applicable to the interest earned. The following examples illustrate the findings in the study.

--New York returned $2.4 million of recoveries made under the Aid to the Aged, Blind, and Disabled Program between February and June 1980. While pending return, these funds were invested and the State earned over $65,000 in interest on these funds. None of this interest was collected by the Federal Government.

--California recovered and invested $2.7 million of Medicaid funds between August 1, 1979, and December 31, 1980. California earned over $267,000 in interest on these funds but did not remit any of the interest to the Federal Government.

State instrumentalities have also failed to return interest on excess Federal funds invested. Under an UMTA grant, audited by DOT's Inspector General, 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 $35 million. With approval of UMTA officials, the 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. The auditors, citing UMTA cash management requirements which state that cash balances should not exceed 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 the MBTA, through April 1982, would have earned $7.2 million in interest on the Federal share of the cash settlement. The auditors also noted that the MBTA was classified as an instrumentality of the State and, as such, was not being held accountable for the interest earned. However, the auditors did not believe the nonaccountability provision was intended to apply to a situation such as this.

We believe that OMB's standards should provide that interest earned by grantees holding Federal funds not pending disbursement for program purposes should be remitted to the

Federal Government consistent with the provisions of 31 U.S.C. 3302, Revised.

Interest earned on program income

Government-wide guidance is needed on the use of interest earned by grantees on invested program income. Such guidance is generally not addressed by individual Federal agencies' regulations except for a few agency components and programs. In the absence of regulations in this area, grantees are guided by State and local laws. Some States provide that all interest received from invested funds belongs to the State, rather than to the program whose funds earned the interest. In other States, interest earned on invested funds belongs to the individual program account and is available for accomplishing program purposes.

Of the six Federal agencies and 18 programs we reviewed, only HHS's Public Health Service (PHS) and UMTA address this issue. PHS's policy states that interest received by grantees as a result of investing program income should be treated as additional program income. UMTA's regulations require that any interest earned on project funds be returned to the project.

Other agencies and programs, however, have no regulations on this type of interest earning; thus, the disposition is guided by State or local law in the States we visited. The different treatments of interest earned by grantees on program income where no Federal policy exists are identified below:

--In Colorado, all wildlife program income is deposited into the States' wildlife accounts. The wildlife accounts, however, are not credited for any interest earned on the funds because the States' statutes require that all interest be credited to the States' general funds.

--In Wyoming and Florida, wildlife program income is deposited in the States' wildlife accounts. Interest earned on these accounts is used for furthering wildlife purposes.

--In Georgia, proceeds derived from special hunting permit fees under the wildlife program are deposited in the State general fund and invested. In the following year, the State appropriates to the State wildlife agency an amount equal to the permit revenues--a practice which, in effect, denies the agency any interest earned on the funds.

--In New Jersey, all lease income and interest thereon generated from State parks developed or acquired with Federal outdoor recreation funds are deposited to the State's general fund.

--In New York, all program income earned under the land management activities supported by the Federal Highway Administration (FHWA) must be deposited in the State's general fund. The interest earned thereon also remains in the general fund.

Under Interior's Outdoor Recreation Program, the issue of interest earned on program income is partially addressed. Some States are involved in the extraction of oil, gas, and mineral deposits from lands acquired with Interior's Outdoor Recreation Program funds. In the cases we reviewed in which States proposed to extract deposits, the agreements between the States and Interior contained provisions requiring that the income be dedicated to outdoor recreation purposes. For the most part, the agreements also specified that any interest earned on invested income must also be dedicated to outdoor recreation purposes.

We believe OMB should establish a standard guiding the disposition of interest earned on invested program income funds. It could consider designing the standard to allow grantees to treat the interest as they treat the program income. Thus, projects could get larger or costs to the Federal Government could be decreased depending upon which program income option is being applied.

BETTER REPORTING OF GRANT-RELATED INCOME IS NEEDED

Although certain types of income are required to be reported, grantees are not reporting millions of dollars of income generated under federally assisted programs. Many grantees are confused by the Federal financial reporting forms and instructions and are not completing the reports or are not completing them accurately. While we were able to identify reported income totaling about $548 million annually, Federal agency officials, for the most part, do not know how much income is being generated and reported.

As a result, Federal agencies' oversight and control of the disposition of the income are impeded. Accurate and complete reporting of grant-related income would produce the information needed by the Federal agencies to effectively oversee and control the significant amounts of income generated under federally assisted programs.

Our review disclosed several reasons why all income is not reported. First, OMB's grant related income standard requires grantees to account for program income but it does not specifically require reporting and does not refer to another OMB standard concerned with financial reporting requirements. Second, OMB's financial reporting requirements standard which specifies forms and instructions for reporting the financial aspects and status of grants does not use the same program income terms as those used in the grant related income standard. Third, Federal agencies do not always require that grantees use the Financial Status Report--the basic form for reporting program income. Rather, some Federal agencies have determined that other OMB prescribed forms provide the needed financial information.

Our review of numerous audit reports and summaries of audit findings prepared by agency and independent auditors for four Federal agencies gives some indication of the extent of nonreporting of program income by grantees. We reviewed nearly all of DOT's audit reports for the period 1975 to mid-1981 and judgmentally selected and reviewed about one-third of Interior's audit reports for the period 1974 to mid-1981 in order to identify those with findings of unreported program income. In addition, we reviewed computerized listings for calendar years 1980 and 1981 of pertinent HHS and Education Department audit findings disclosing unreported program income. The following table shows the results of these reviews.

Agency	Unreported income as identified in audit reports
Department of Health and Human Services	$13,453,337
Department of Education	860,891
Department of the Interior	3,852,377
Department of Transportation	11,567,429
Total	$29,734,034

While this list cannot be considered a thorough or comprehensive compilation of data on program income, we believe it does indicate the magnitude of program income not being reported by grantees of these agencies.

All grant-related income should be reported to Federal agencies

OMB's grant related income standards require grantees to account for income but do not specifically require reporting. Another OMB standard provides a form for grantees to report on the financial aspects of grants, including program income. However, the instructions are not clear, and the use of the form is not always required. In addition, only certain types of income are required to be reported and then only when the grant agreement specifies the additive or deductive option.

The basic financial reporting form prescribed by OMB's standards is the Standard Form 269: Financial Status Report (FSR). We found that this form and the instructions for reporting program income are misunderstood by some grantees, and the form is not always required to be used. Also, no requirement exists for reporting (1) income used under the cost-sharing option, (2) the source, amount, and disposition of income when the grant agreement fails to specify an option for using the income, and (3) other types of grant-related income. As a result, some grantees reported income inaccurately or did not report income at all.

The FSR provides space for reporting program income when the additive or deductive options are specified in the grant award. On the face of the report form, the only reference to program income is on line 10c which calls for program income credits to be subtracted from the total outlays.

The instructions for reporting program income appear in two places on the back of the form and read as follows:

> line 10b "Enter the total gross program outlays (less rebates, refunds, and other discounts) for this report period, including disbursements of cash realized as program income* * *."
>
> line 10c "Enter the amount of all program income realized in this period that is required by the terms and conditions of the Federal award to be deducted from total project costs. For reports prepared on a cash basis, enter the amount of cash income received during the reporting period. For reports prepared on an accrual basis, enter the amount of income earned since the beginning of the reporting period. When the terms or conditions allow program income to be added to the total award, explain in remarks, the source, amount and disposition of the income."

The FSR provides only a small space for "remarks" on line 12, which may limit its usefulness for reporting the requested information.

Apparently these instructions were not understood by all grantees. For example, a Runaway Youth Program grantee in Oregon was not reporting program income to HHS because it was misinterpreting the FSR. The grantee's accountant explained that program income is not shown as program income credits (line 10c, FSR) because "* * * program income is added to the program, not credited." The accountant did not realize that the income should have been reported in the remarks section (line 12, FSR). The accountant was also reporting only Federal fund expenditures and not total program expenditures, and he said that no questions were raised by the Federal agency. A Community Mental Health Center grantee in New York was not properly reporting all program income to HHS because, as a grantee official stated, he did not know how to show program income on the reporting form. This grantee failed to report about $718,000 in program income.

In New York, we noted that one Community Health Center Program grantee earned program income but, because of confusion over the reporting requirements and forms, did not properly complete the FSR. Program income was reported in the "remarks" section; however, the grantee included funding sources, such as the Federal grant award itself, in the program income total. Therefore, the grantee incorrectly reported a much larger program income amount than was actually generated. The grantee's FSR showed over $3,816,000 in program income; however, only about $1,513,000 in program income was generated according to a certified audit report. A grantee official said the FSR

--reporting instructions are unclear,

--should be expanded to provide line items for sources of income, and

--reflects unaudited and in many cases incorrect figures because the report is required before the final audit.

In addition, an HHS regional grants official said the FSR does not provide the type of information needed to properly administer the program because the report does not provide complete and comprehensive financial information or individual line items for sources of income and expenditures.

When grantees use program income under the cost-sharing option, OMB's financial reporting standards do not require reporting because they were developed in the early 1970's and were not changed when the cost-sharing option was first

allowed in the mid-1970's. Also, the income reporting requirements are geared to the option (additive or deductive) specified in the grant agreement. We found, however, that grant agreements rarely specify an option.

Other grant-related income, such as interest and sales proceeds, is not required to be reported. Rather, interest earned by non-State agencies and proceeds from sales generally are to be remitted to the Federal Government, but grantees do not always remit the income. In other cases, grantees are allowed to keep interest and sales proceeds. In both situations, however, grantees are not required to identify such income in their periodic reports, and thus, Federal agencies do not know how much income was generated or how it was used.

We found several cases where grantees earned interest or received sales proceeds; but because of the lack of reporting requirements, Federal agencies were unaware of the occurrences. A Community Health Center grantee in South Carolina sold 18 used motor vehicles unbeknown to HHS. In New York, UMTA did not know that a grantee received $10,500 from the sale of an excess number of buses. In both cases, the proceeds were neither remitted nor reported to the Federal agencies at the time of the sale.

A Florida State grantee earned $108,000 in interest on funds received from leasing a wildlife management area. The grantee reported the lease transaction and lump-sum payment to Federal officials, but the officials were unaware that interest was being earned because the grantee was not required to report it.

The OMB standards provide Federal agencies with the option of not using the FSR when adequate information is given on the OMB SF 270: Request for Advance or Reimbursement, or SF 272: Federal Cash Transactions Report. Though both of these forms provide space for grantees to report on program income, each is for a different purpose and requires reporting in a different manner from the FSR. Furthermore, the language on these forms concerning the reporting of income is confusing because it does not clearly relate to the language used in the OMB standard regarding the options for using program income.

The stated purpose of SF 272 is to assist Federal agencies in monitoring advances to grantees and to obtain disbursement information. The stated purpose of SF 270 is for grantees to request advances and reimbursements. Unlike the FSR, SFs 270 and 272 do not require the grantee to show the source of the program income funds or the disposition of the income in terms of the program income options.

The program income language on both forms does not clearly relate to the language of OMB's program income attachment. For example, the instructions for SF 270 require grantees to "* * *enter only the amount applicable to program income that was required to be used for the project or program by the terms of the grant or other agreement." The only language in the program income attachment that is close to this language is that used to describe the additive option, and thus it may be confusing to grantees using other options. OMB officials told us, however, that income used under any of the three options must be subtracted for purposes of determining cash advances. Furthermore, the subtracting of income is guided by the terms of the grant, but as discussed later, grant agreements rarely specify the program income option.

The SF 272 requires grantees to "Enter the Federal share of program income that was required to be used on the project or program by the terms of the grant or agreement." No explanation is provided on either the form or in OMB's program income attachments as to what the "Federal share" is or how it is calculated. No other OMB-prescribed financial reporting form requires a separate statement of the Federal share of program income.

In our opinion, SFs 270 and 272 are not adequate forms for grantees to use for reporting on the source, amount, and disposition of program income. We believe it would be desirable for OMB to revise the grant related income standard to (1) specifically require grantees to report income, (2) require reporting in terms consistent with OMB's financial reporting requirement standard, and (3) require the reporting of all types of grant-related income. We also believe that OMB should revise the FSR to provide space for reporting the source, amount, and disposition of all types of grant-related income and to require agencies, grantees, and subgrantees to use the FSR.

CLEARER GUIDANCE NEEDED ON USING PROGRAM INCOME OPTIONS

The options available for using other program income are not being properly implemented and as a result, the objectives of the additive and deductive options are not always being fully achieved. Federally assisted programs are not always expanded when the additive option applies, and Federal costs are not always reduced when the deductive option applies. Federal agencies and grantees need to better comply with regulations, and OMB needs to clarify and emphasize the guidance provided for using the program income options.

Options should be specified

OMB's standards provide that the grant agreement is to specify the option to be used for disposing of program income. In most of the grant agreements we reviewed, however, the option wasn't specified. Some agencies' regulations have provisions to deal with this situation but most do not. When an option is not specified either in grant awards or agencies' regulations, Federal agencies, in effect, lose the ability to direct grantees' use of any program income generated; hence, grantees either decide which option to use or follow provisions of State or local laws in the handling of program income.

We found that Federal programs often have not benefited from the income generated--programs have not been expanded and Federal costs have not been reduced. For example, under FHWA's regular highway construction program, many States generate income from leasing the acquired lands and improvements thereon before or during highway construction. In New York, more than $1.6 million was generated between April 1980 and March 1981 from rentals and sales of land and buildings. According to State 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. In Washington State, officials told us that the income generated from leases or rentals of property managed under the regular highway construction program--nearly $325,000 annually--is deposited, in accordance with State law, to the State Motor Vehicle Fund. This fund is used for both highway construction and nonconstruction activities.

Outdoor Recreation Program grant awards seldom specify which program income option applies. New Jersey generated $72,000 from lease income in 1980 at a State park funded under Interior's Outdoor Recreation Program. An additional $105,000 was generated at other State parks, some of which received Federal outdoor recreation funds. None of this income was credited to the project or reported to Interior, but in accordance with State law, it was deposited to the State general fund.

Under UMTA's Capital Improvement Program, grantees receive income from leasing property acquired with Federal assistance. Although UMTA officials told us they expect grantees to use the deductive option, UMTA has no regulations on the disposition of program income, and its grant awards do not specify an option. As a result, grantees themselves decide what to do with income generated. In a review of seven grantees, Transportation's auditors found that $575,000 of rental income was used for transit operating costs and other non-grant costs.

Two agencies have made provisions in their regulations to deal with the situation where an option is not specified in the grant agreement. HHS and Education regulations provide that if the grant agreement does not specify the option, the deductive option is required. Most other agencies, however, do not address the issue of which option will be used or who will select the option if the grant agreement does not specify it.

Federal agencies can overcome the problems discussed above if they always specify an option in their grant awards. Recognizing, however, that such specification may be inadvertently omitted, it seems desirable for agencies to provide in their regulations for a fall-back option in these cases. We believe OMB can accomplish this by revising its program income standards to direct Federal agencies to establish regulations that designate which option applies when grant agreements fail to do so. This would better ensure that when grantees receive income from operating federally assisted programs, the income is applied toward accomplishing the program income objectives.

Deductive option needs clarification

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. The net effect is that if program income is unexpectedly earned, the Federal and grantee funds needed to carry out the project will be less than that reflected in the approved budget.

Although only a few grants we reviewed specified the use of this option, we found that the deductive option often produced the results intended by the additive option. This occurred when Federal agencies allowed grantees to exceed their budgets and use the program income to fund the additional expenditures. Operationally, therefore, the grantee uses the program income to expand the project and, for accounting purposes, deducts the program income from the increased rather than budgeted total costs before computing the respective Federal and non-Federal shares. As a result, the program income and additional expenditures are in effect netted-out, and the Federal share is not based on a reduced amount as intended by the deductive option.

A PHS Community Mental Health project in Washington illustrates how the deductive method does not accomplish its objectives when total project costs are not limited to the grant budget. Federal funds of $217,533 together with a grantee share of $285,467 and anticipated program income of $137,000, comprised the grant budget of $640,000. The grant

award specified the deductive option for handling any additional program income.

During the project period, the project had additional program income of $50,901, which, by applying the deductive option, would have been shared between the Federal agency and the grantee in proportion to their original shares. However, instead of reducing the Federal and grantee shares, the grantee added $47,927 to the project and reduced its share of project costs by the remaining $2,974. PHS approved a revised budget at the end of the grant year to authorize the increased actual expenditures. While this legitimized the grant activities, it, in effect, changed the use of the program income so as to accomplish the results obtained under the additive rather than the deductive option.

As previously noted, UMTA officials expect grantees to use the deductive option. We found, however, that program income was being earned without correspondingly reducing Federal and grantee costs because project costs were allowed to increase above the grant award budget. UMTA generally requires grantees to submit revised budgets; but while this action legitimizes the increased grant budget, it also has the effect of changing the use of the program income so as to obtain the results under the additive rather than the deductive option.

We recognize that circumstances may dictate the desirability of revising budgets and/or program income options during the course of, or upon completion of, projects. These examples demonstrate, however, that agencies and grantees need to closely monitor program income and limit project expenditures to the amount in the approved budget if the deductive option is to operate as intended.

We believe OMB should apprise Federal agencies of this situation by expanding the description of the deductive option within the standard to emphasize the option's purpose and the controls necessary to achieve its objective.

CONCLUSIONS

Office of Management and Budget Circulars A-102 and A-110 provide useful Government-wide standards for handling many grant related income issues. Other standards are needed, however, to handle additional grant related income issues. Specifically, standards are needed on the (1) timing and allowability of income expenditures, (2) classification of oil, gas, and mineral income, and (3) disposition of several types of interest income. We believe these issues, like other issues involving grant-related income, should be guided by Government-wide standards.

Some of the existing standards also need improvement. Grantees are failing to report millions of dollars of income, in part, because the financial reporting forms and instructions are neither clear nor inclusive. Accurate and complete reporting of all grant-related income would produce the information needed by Federal agencies to effectively oversee and control the significant amounts of income generated under federally assisted programs.

OMB also needs to expand on the guidance provided for using the program income options. Because Federal agencies often award grants without specifying which program income option applies, OMB should direct Federal agencies to specify a fall-back option in their regulations. Also, OMB needs to expand the standards' discussion of the deductive option's purpose and the controls needed in using it. Improvements such as these would provide greater assurance that when grantees receive income from operating federally assisted programs, the income will be applied toward accomplishing the program income objectives.

RECOMMENDATIONS TO THE DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

We recommend that the Director, Office of Management and Budget, revise Circulars A-102 and A-110 to:

--Establish standards addressing the timing and allowability of program income expenditures and the classification of income derived from products of the land such as oil, gas, minerals, gravel, and standing timber.

--Establish standards for the disposition of interest earned on (1) program income, (2) funds not pending disbursement because of completed projects, audit exceptions, or contract settlements, and (3) sales proceeds.

--Expand the definition of program income and the financial reporting requirements to ensure that all income generated under federally assisted projects, including interest and sales proceeds, is accounted for and reported by assistance recipients.

--Clarify in the instructions for Standard Forms 270 and 272 that all income retained by grantees is to be subtracted on their requests for drawdowns.

--Incorporate in the standards a statement that Federal agencies should specify in their regulations which

program income option is to be used by grantees when grant agreements fail to specify an option.

--Expand the description of the deductive option to note that its objective of reduced costs to the Government will not be achieved unless total grantee expenditures are limited to the budgeted amount approved in the grant award.

AGENCY COMMENTS AND OUR EVALUATION

OMB commented that our report was helpful in identifying some areas where improvements are needed and that it will be of immediate use because OMB is planning to review all of the provisions of Circulars A-102 and A-110. OMB added, however, that it may need to see more documentation before moving ahead with extensive changes. (See app. III.)

OMB asked us to provide certain information, such as the amount of unreported income and the number of inaccurate reports, so that the problems could be put in their proper perspectives. We did not develop the type of information OMB requested because our objective was not to evaluate the level of agencies' and grantees' compliance with the program income standards but rather to evaluate the clarity and completeness of the standards themselves. Accordingly, we assessed selected instances of Federal agencies' and grantees' compliance with the standards for the purpose of determining whether the causes of noncompliance were systemically related to the OMB standards and demonstrated a need to modify them on a Government-wide basis. In our assessment of the completeness of the standards, noncompliance in terms of unreported income and inaccurate reports was not an issue. Our purpose here was to determine whether situations involving grant-related income were occurring but not being addressed by the standards.

OMB also expressed interest in learning more about the program income findings identified in audits by Federal agencies and independent auditors. As stated in the report, we did not follow up on all the audit reports because of their great number and the fact that we used the audit reports only for the purposes of (1) identifying which programs were generating what types of income and (2) determining program income practices of Federal grant administrators and grantees. We therefore suggest that OMB contact agency Inspectors General for more detailed information.

Regarding our specific recommendations, OMB agreed that (1) standards should be established for disposing of and reporting on different types of interest income, (2) program income should generally be subject to the same cost standards

as grant funds, (3) program income should be reported when used as cost-sharing, and (4) the instructions on SF's 270 and 272 may need some clarification.

OMB noted, however, that all of our recommendations were addressed to it even though some of the findings seemed to suggest that individual Federal agencies are not effectively monitoring their grant programs. We agree with OMB and have made, or are in the process of making, recommendations on program management in reports to individual agencies. But, even if Federal agencies improve their program management as suggested by OMB, the objective of uniform Government-wide implementation will not be fully achieved because the standards do not address, or are unclear on, certain program income issues. For example, Federal program managers can oversee grants and ensure that grantee financial management systems produce reliable data and reports; but without a standard addressing the timing of program income expenditures, agencies' practices will continue to vary in terms of whether and how they address the issue.

OMB seems to disagree with our recommendation calling for a standard on the classification of income derived from products of the land such as oil, gas, and other minerals. OMB questioned the significance of such income and whether any of it was handled improperly. We are in no position, nor do we believe are OMB or Federal agencies, to state the potential magnitude of such income. Nor are we in a position to determine how such income should be handled unless statutory or regulatory requirements address the issue. Considering the diversity of Federal programs, OMB said it is not surprising that the same type of receipts are treated differently and that perhaps this is justifiable. We don't disagree, but it seems the same argument could also be made for the other types of grant-related income. Our only point is that because OMB's standards are intended to guide and yield uniformity in the way Federal agencies address various types of grant-related income, the standards should address grant-related income associated with the extraction of oil, gas, and other minerals.

OMB agreed to establish standards on the disposition of interest but assumed these standards would cover the definition as well as the reporting of interest. We were not operating under this same assumption and made a separate recommendation on expanding the definition of program income and the financial reporting requirement because the standards, as currently structured, deal with definitional, disposition, and reporting information in different places. Thus, it appears the only point of disagreement on our recommendation to expand the program income definition and reporting requirement centers on grantees' reporting of sales proceeds.

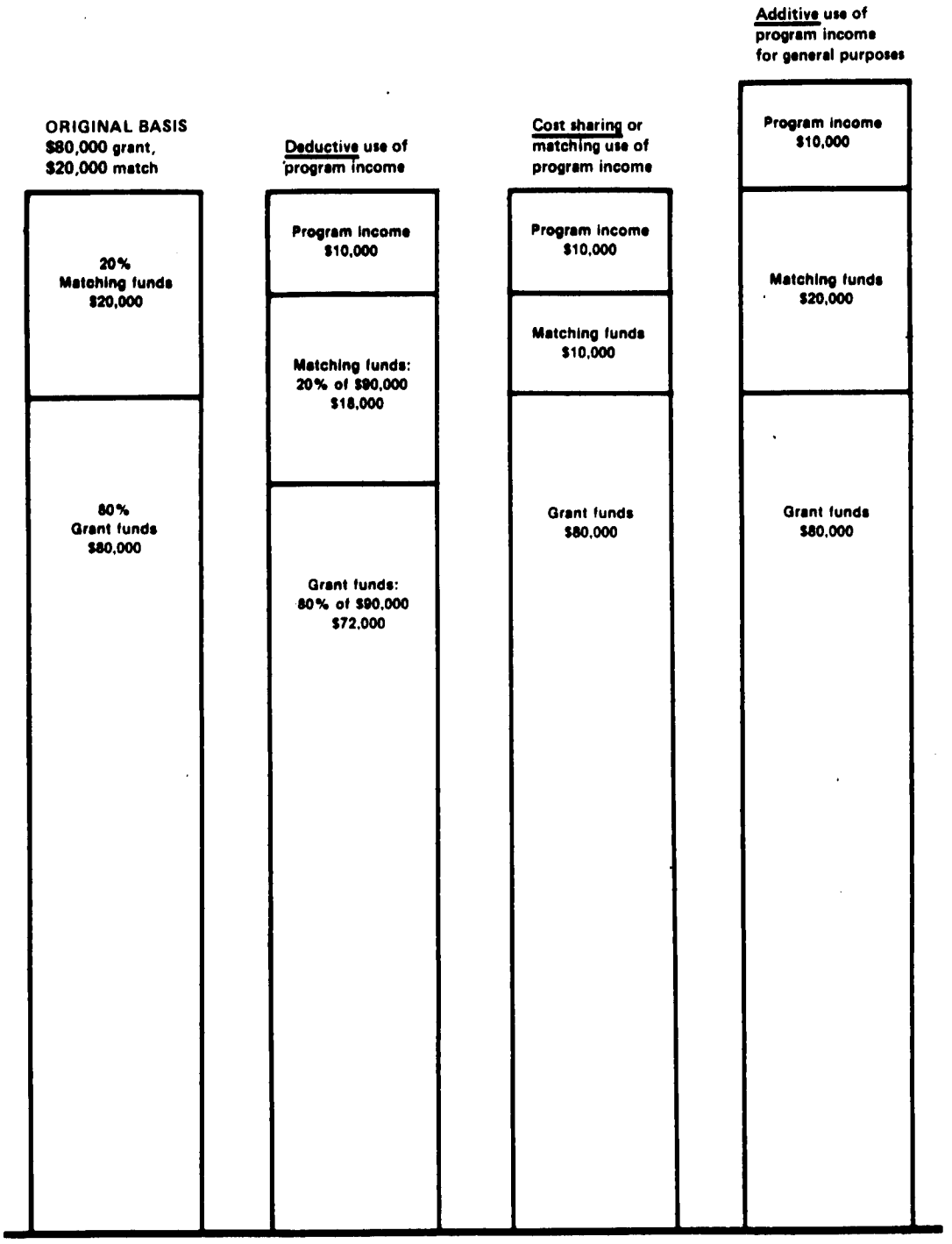
OMB commented that our report cites $29 million of unreported income based on audit reports of four agencies but it doesn't indicate why that income was not reported or that the failure to report was caused by a lack of OMB guidance. We acknowledge that in some cases grantees did not comply with existing reporting requirements. But when interest earnings and sales proceeds went unreported, it was due to the lack of an OMB standard and an agency reporting requirement. To the extent grantees remit the Federal share of the sales proceeds as required, there is, in effect, a reporting made to the Federal Government. We believe that a requirement to report sales proceeds would help to ensure that they are ultimately remitted when remittance is required. Further, under some programs such as the Interior's Wildlife Restoration, grantees may retain sales proceeds and use them to further the purposes of the respective program. A reporting requirement would provide Federal agencies a more effective means of monitoring the source, amont, and disposition of sales proceeds as is the case with other program income.

In commenting on our last two recommendations concerning specifying which income option grantees are to use and expanding the description of the deductive option, OMB said we should direct these recommendations to the agencies involved. We agree with OMB and, as stated earlier, we have made, or are in the process of making, recommendations to the Federal agencies included in our review. However, we consider our recommendations to OMB to be appropriate because their adoption and inclusion in the circulars would provide standards for all Federal agencies as well as for the agencies we reviewed. To do otherwise would result in only those agencies and their programs where we found particular problems being alerted to the problems. Those agencies, programs, and grantees which we did not review, or where we did not look for or find a problem, would not be apprised of the problems even though they may be experiencing problems.

In summary, we continue to believe it is important and necessary for OMB to modify its standards along the lines we recommend because the systemic problems we noted and their solutions will then be addressed in the documents which communicate Federal assistance guidance on a Government-wide basis.

APPENDIX II

USE OF PROGRAM INCOME



Source: Department of Health and Human Services

APPENDIX III

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MAY 2 1983

Mr. William J. Anderson
Director, General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

This is in reply to your letter of March 31, 1983, requesting comments on the draft report, "Improved Standards Needed to Deal With Income Generated Under Federal Assistance Programs."

The report concludes that Office of Management and Budget Circulars provide useful Government-wide guidance and standards for dealing with income generated under federally assisted programs. The report also points out that additional standards are needed on some grant related income issues, and some existing standards needed to be clarified.

The report is helpful in identifying some areas where improvements are needed in reporting for grant program income. It will be of immediate use since we are planning to review all of the provisions of Circular A-102 "Uniform requirements for grants to State and local governments" and Circular A-110 "Uniform requirements for grants and other agreements with hospitals, universities and other non-profit organizations. However, before moving ahead with extensive changes to the Circular suggested by the report, we may need to see more documentation of the need for these changes.

We noted that all of the recommendations in the report are addressed to OMB even though some of the findings seem to suggest that Federal agencies are not effectively monitoring grant programs. For example, on page 20 the report cites an example of a Florida grantee earning $108,000 in interest on funds received from leasing a wildlife management area. The report alleges Federal officials were not aware of the interest income because of a lack of OMB reporting requirements. Yet, the report states the grantee had reported the lease transaction and lump sum payments

APPENDIX III

to Federal officials. The report does not explain whether an adequate review of the initial transaction by the Federal agency would have disclosed the grantee was earning interest on the lease.

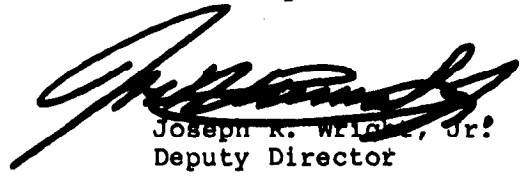
There are two other questions regarding the report. The report shows 18 programs and 146 grantee/subgrantee were reviewed. In order to put the problem in its proper perspective it would be helpful to know:

...the dollar amount of program income reviewed
...the dollar amount of program income not reported
...the number of reports reviewed
...the number of reports that contained inaccurate data.

Also, we would be interested in knowing more about the reasons for and the disposition of unreported program income funding uncovered by the Federal agencies in their audit reports. Page 17 of the report shows almost $30 million in program income was uncovered by Federal agency and independent auditors. To the best of our knowledge, these audit reports were not referred to OMB for policy action.

Enclosed are our responses to the six recommendations contained in the report. Thank you for the opportunity to review this report.

Sincerely,



Joseph R. Wright, Jr.
Deputy Director

Enclosure

APPENDIX III

OMB Response to GAO Recommendations
in the Draft Report
"Improved Standards Needed to Deal with Income
Generated Under Federal Assistance Programs"

The draft report on Income Generated Under Federal Assistance Program recommends that the Director of Office Management and Budget make six revisions to Circulars A-102 and A-110.

GAO Recommendation 1:

" Establish standards addressing the timing and allowability of program income expenditures, and the classification of income derived from products of the land such as oil, gas, minerals, gravel and standing timber."

OMB Response. We agree that changes may be necessary to the Circulars to clarify the various types of interest income that must be reported. However, we believe the provisions of the Circulars, including the financial reporting instructions, are adequate for most of the program income generated by grantees. Each one of the four financial reports in the Circular and the grant application forms address program income. In addition, we believe that many of the instances of unreported income disclosed in the report could have been uncovered by more effective program management in the agencies. Additional standards for the timing of program income are not a good substitute for Federal program managers overseeing the grants and ensuring that grantee financial management systems produce reliable data and reports.

Concerning the allowability of program income expenditures, we agree that program income generally should be subject to the same standards as grant funds. However, there may be instances where a grantee is almost totally dependent upon program income to meet its matching share and other necessary expenditures that may not be allowable under the cost principles. Therefore, the program income standards must contain some flexibility. We will review this area, however, as part of our overall review of the Circulars.

APPENDIX III

With respect to guidance needed for classifying proceeds from the sale of oil, gas and other minerals, the report does not appear to document a significant problem. The report points out some Federal agencies are classifying proceeds from selling timber, gravel, oil, natural gas and other minerals as program income while other agencies are classifying the income as sales proceeds. Considering the diversity of Federal programs it is not surprising that the same type of receipts are treated differently and this may be justified. If there is a problem here it would be helpful if the report disclosed its potential magnitude. From the draft report it is not clear that even one instance was uncovered where these types of receipts were handled improperly.

GAO Recommendation 2:

" Establish standards for the disposition of interest earned on (1) program income, (2) funds not pending disbursement because of completed projects, audit exceptions, or contract settlements, and (3) sales proceeds."

OMB Response: We agree. The program income provisions of the Circulars will be expanded to provide standards for the disposition of interest earned on the three types of transactions mentioned in the recommendation.

GAO Recommendation 3:

" Expand the definition of program income and the financial reporting requirement so that all income generated under federally assisted projects, including interest and sales proceeds, is accounted for and reported by assistance recipients."

OMB Response: We assume the standards for the disposition of interest in recommendation 2 would cover the definition as well as the reporting of interest. Therefore, it is not clear why interest is mentioned in this recommendation.

APPENDIX III

With respect to the rest of the recommendation, we believe that it should be narrowed to address only those instances where program income is used by the grantee to meet a cost sharing option. We agree that the Circular does not adequately address the reporting of this rather minor amount of income.

Concerning other types of income, the findings in the report do not appear to support the recommendation. The $29 million cited as unreported income on page 17 was a summary of findings found in the audit reports of four agencies. There is no evidence that GAO examined these reports to determine why the income was not reported or that the failure to report it was caused by a lack of OMB guidance.

GAO Recommendation 4:

" Clarify in the instructions for Standard Forms 270 and 272 that all income retained by grantees is to be subtracted on their requests for drawdowns."

OMB Response: We will take your observations into consideration when we make our overall review of the Circulars. However, we do not agree with the inferences that confusing language in the financial reporting forms is the primary cause of unreported income. The report cites two instances on page 20 where grantees sold vehicles and did not report the income because of the lack of reporting requirements. The report does not mention that Attachment N to the Circular calls for the grantee to request disposition instructions from the Federal agency for unneeded grant property. Further, the Circulars states if the grantee is instructed to sell the property the Federal agency shall be reimbursed for the Federal share. The instructions are clear. If a grantee chooses not to comply, it is not the fault of the instructions.

GAO Recommendation 5:

" Incorporate in the standards a statement that Federal agencies should specify in their regulations which program income option is to be used by grantees when grant agreements fail to specify an option."

APPENDIX III

OMB Response: We believe that this issue should be addressed to the Federal grantmaking agencies. The policy in the Circular is clear; federal agencies should ensure that it is carried out.

GAO Recommendation 6:

" Expand the description of the deductive option to note that its objective of reduced cost to the Government will not be achieved unless total grantee expenditures are limited to the budgeted amount approved in the grant award."

OMB Response: Again, this appears more an agency problem than an OMB one. As the report states, in the few cases examined "..agencies and grantees need to closely monitor program income and limit project expenditures to the amount in the approved budget...." We suggest this recommendation be directed to those Federal agencies that made awards with the overruns.

(017704)

GE

25802

AN EQUAL OPPORTUNITY EMPLOYER

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

OFFICIAL BUSINESS
PENALTY FOR PRIVATE USE,$300

POSTAGE AND FEES PAID
U. S. GENERAL ACCOUNTING OFFICE

THIRD CLASS