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

B-176480

DEC 15 1972

Dear Mr. Secretary:

By letter of July 6, 1972, Miss Sarah H. Spector, Chief, Litigation and Claims Branch, Division of Business and Administrative Law, Office of the General Counsel, Department of Health, Education, and Welfare, transmitted for appropriate action under the Federal Claims Collection Act, 31 U.S.C. 951-953, and implementing regulations (4 CFR 101.1-105.7) files relating to claims by the Department of Health, Education, and Welfare (HEW) against the New York State Department of Social Services in the amount of $16,141.97, and against the New Jersey Rehabilitation Commission in the amount of $4,970. By letter of September 7, 1972, Miss Spector transmitted files relating to claims by HEW against the Pennsylvania Bureau of Vocational Rehabilitation in the amount of $36,456, and against the Pennsylvania Department of Public Welfare in the amount of $1,363.

Section 221 of the Social Security Act, as amended, 42 U.S.C. 421, authorizes the Secretary of HEW to enter into agreements providing for the making of disability determinations by the States as set forth in that section. Section 221 provides, in part, that:

> "(e) Each State which has an agreement with the Secretary under this section shall be entitled to receive from the [Federal Old-Age and Survivors Insurance and Federal Disability Insurance] Trust Funds, in advance or by way of reimbursement, as may be mutually agreed upon, the cost to the State of carrying out the agreement under this section. The Secretary shall from time to time certify such amount as is necessary for this purpose to the Managing Trustee, reduced or increased, as the case may be, by any sum (for which adjustment hereunder has not previously been made) by which the amount certified for any prior period was greater or less than the amount which should have been paid to the State under this subsection for such period; and the Managing Trustee, prior to audit or settlement by the General Accounting Office, shall make payment from the Trust Funds at the time or times fixed by the Secretary, in accordance with such certification. * * *
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> "(f) All money paid to a State under this section shall be used solely for the purposes for which it is paid;

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and any money so paid which is not used for such purposes shall be returned to the Treasury of the United States for deposit in the Trust Funds."

All of the instant claims arise on the basis of audit exceptions taken for interest allegedly earned but not reported by the respective State agencies on advance or estimated payments made under section 221(a) for various periods ranging from July 1, 1954, to June 30, 1965.

The facts relating to each claim are largely the same. In each case payments to the State agency under section 221 were commingled with other funds under State control, derived from State and other Federal sources, i.e., section 221 payments became merged generally into the total balance of State funds. Under each State's fiscal procedures, a portion of the total State fund balance is placed in interest bearing accounts, while the remainder is maintained in "open" or "demand" accounts which do not earn interest. The State procedures do not identify either portion of such funds in terms of their specific sources. In view of the foregoing, HEW apparently arrived at the amount of each claim for interest by applying to the total interest earned by each State the ratio of section 221 payments to the total State fund balances in both interest and noninterest bearing accounts. Thus each claim represents an estimated pro rata share of all interest earned, based upon a formula treating section 221 payments as attributable in part to interest bearing accounts and in part to open account. *See, e.g.*, memorandum of June 3, 1964, from the HEW Regional Auditor, New York, to the Chief, Field Branch, Division of Grant-in-Aid Audits.

Each State agency appealed the audit exception on the ground that section 221 payments should be considered attributable entirely to the noninterest bearing accounts. The positions of the three States are set forth in the files transmitted as follows:

1. Excerpt from a letter of July 17, 1963, from the Comptroller of the State of New York and the Commissioner of Taxation and Finance to the New York Commissioner of Social Welfare:

"Apart from any legal questions which may be involved, this Federal claim is based upon the erroneous assumption that the balances of such Federal grants were, and presently are, a part of those State funds, and funds under State control, deposited in interest bearing time deposit open accounts in banks throughout the State. Such is not the fact.

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"Attached is a tabulation of the monthly balances in the funds of the State, including those received from various Federal grants. After deducting the balances in the State Employees' and Hospital Employees' Retirement Accounts as well as the balance in the Unemployment Insurance Benefit account, the attached schedule conclusively shows that at all times the balances in the subject Federal grants were substantially less than that portion of all funds on deposit on a demand basis and on which, of course, no interest is received.

"As joint custodians of these funds it was determined, as a matter of policy, that the total amount in demand deposits, both in checking and so called dormant bank accounts, should at all times exceed the Federal grant balances. This was deemed necessary because of the patterns of cash flow from these funds of Federal origin. This likewise became an important factor in determining the maximum overall amount that could be placed in interest bearing time deposit open accounts." (Underscoring in original.)

2. Excerpt from letter of April 19, 1965, from the State Treasurer of New Jersey to the HEW Regional Representative:

"New Jersey takes the position that it has not invested Federal funds during the period covered by your audit. While it is true that New Jersey commingles all funds in one treasury and has followed the suggestions outlined by the Commission on Intergovernmental Relations to put to work idle funds, we have consistently retained as demand deposits more than $6 million daily. This includes all Federal funds advanced and unused for Federal programs.

"It is our position that any funds earning interest in New Jersey in its General Treasury represent State funds only. All Federal funds are kept in demand balances."

3. Excerpt from letter of May 22, 1972, from the General Counsel of the Pennsylvania Department of Labor and Industry to the Social Security Commissioner:

"The Pennsylvania State Treasurer has indicated that the federal funds heretofore mentioned were included in active bank accounts balances. Active bank deposits are not interest bearing; therefore, our State Treasurer advises us that the invoice rendered by the United States Department of Health, Education and Welfare is not in order."

With respect to the New York position, the HEW auditor responded that the State had omitted certain payments by Federal agencies other than HEW from its calculation of Federal fund balances; and that inclusion of these payments indicated that total Federal fund balances "not infrequently" exceeded the State's total balance for noninterest bearing funds. Memorandum of June 3, 1964, from the HEW Regional Auditor, New York, supra. With this exception, the factual positions taken by the States appear to be uncontested. A memorandum dated July 31, 1963, from the HEW Regional Attorney, Region II, to the Regional Auditor adopted the following legal position in the New York case:

"* * * [I]t is now well established that upon receipt by a State, Federal grants-in-aid become State funds impressed with a condition in the nature of a trust that such funds be used for the purpose and in accordance with the requirements of applicable Federal law. In a long line of decisions by the Comptroller General of the United States, he has ruled that if in connection with its handling of such funds, interest or earnings accrue, irrespective of whether such earnings are described as interest or by any other designation, all such earnings become impressed with the same condition in the nature of a trust as applied to the federally granted funds. Such rulings make clear that upon receipt by a State, such federally granted funds become State funds subject to established State procedures governing the handling of State funds, except of course to the extent that any Federal requirement directs otherwise. Such federally granted funds are in this respect therefore commingled with other State moneys and are not earmarked as Federal moneys.

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"No [applicable] provision of Federal law or regulation * * * requires that Federal funds be earmarked and not commingled with State funds for purposes of their deposit in banks or other types of depositories.

"In view of the foregoing, you are advised that no basis exists for treating Federal funds as solely funds deposited

> in demand deposits under the above-described State procedure. Under the above rulings of the Comptroller General, the Federal agencies administering the grants involved are obligated to assure that interest earned on such grants are proportionately prorated and that such prorated share accrues to the benefit of the United States Government."

The foregoing position was affirmed in a decision by the Social Security Commissioner dated February 11, 1965, which is apparently followed for all of the claims here involved. However, no attempt was made to collect these claims pending consideration of legislation eventually enacted as the Intergovernmental Cooperation Act of 1968, approved October 16, 1968, Pub. L. 90-577, 82 Stat. 1098, 42 U.S.C. 4201.

Section 203 of the Intergovernmental Cooperation Act, 42 U.S.C. 4213, provides, in part:

> "* * * States shall not be held accountable for interest earned on grant-in-aid funds, pending their disbursement for program purposes."

Section 106 of the act, 42 U.S.C. 4201(6), defines the term "grant-in-aid" to include, inter alia, payments to States under a fixed annual or aggregate authorization which either requires some matching on the part of the States or operates on a formula basis. Section 106(7) specifically excludes from the definition of grants-in-aid "payments to States or political subdivisions as full reimbursement for the costs incurred in paying benefits or furnishing services to persons entitled thereto under Federal laws." In a letter of January 24, 1969, to the then Deputy Director of the Bureau of the Budget, B-146285(6), we held that the provision of section 203 of the act relieving the States of the obligation to account for interest earned on grant-in-aid funds applied retroactively.

As a result of enactment of the Intergovernmental Cooperation Act and our decision of January 24, 1969, the original amounts of the instant claims were reduced by the elimination of interest claimed on grant-in-aid payments. However, in an opinion dated April 29, 1969, the HEW General Counsel's Office took the position that payments to the States under section 221 of the Social Security Act are not grants-in-aid under section 106 of the Intergovernmental Cooperation Act, but fall within the specific exception contained in section 106(7) as to payments in the nature of reimbursement for services furnished by the States. Consequently, this opinion concluded that recovery of interest earned on section 221 payments is not foreclosed by section 203 of the Intergovernmental Cooperation Act.

Assuming but not deciding that the States would be liable to repay any interest earned on section 221 payments and that such liability would not be affected by section 203 of the Intergovernmental Cooperation Act, we believe that the files transmitted fail to establish a factual basis sufficient to justify the conclusion that interest was actually earned on the section 221 payments here involved.

As noted previously, the record with respect to each claim indicates that section 221 payments were commingled with other funds in the custody of the respective States, and that each HEW claim represents a pro rata share of the total interest earned on funds held by each State. In this respect, the instant factual context is similar to that considered in our letter of June 2, 1964, B-153085, to the Comptroller of the Treasury of the State of Tennessee, wherein an audit by the Department of Agriculture charged the State a pro rata share of interest earned on commingled Federal payments made under the National School Lunch Program and the Special Milk Program. Responding to the Tennessee Comptroller's request to discuss the matter, we stated in part:

> "Likewise, we have considered your contention that notwithstanding the commingling of Federal and State funds in State depository bank accounts, the funds withdrawn therefrom and invested at interest in compliance with State law represented State funds only, since the balances of funds on open accounts are many times the total amounts of Federal funds on deposit. We believe there may be reasonable basis for this view. That is, if it can be shown as a matter of fact that the State's expressed investment policy excluded from investment Federal grant funds, that the daily balances of funds on open accounts in the State general fund accounts were in excess of the amounts required by the State to meet its commitments, including those pertaining to all State and Federal grant programs, and that the State would not have been required to maintain larger daily balances of funds but for the Federal funds advanced as grants-in-aid, we believe that interest received by the State on the funds withdrawn therefrom for investment properly may be regarded as interest received on State rather than Federal funds. * * *"

We went on to point out that the mere allegation that balances of open accounts exceeded the total amount of Federal funds held by the State might not of itself be sufficient to negate a claim for interest; and that resolution of the matter should be taken up with the Department of Agriculture.

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We believe that the general approach indicated in the portion of our letter of June 2, 1964, quoted above—that under certain circumstances interest earned on commingled funds held by the States is not, as a matter of fact, attributable to the Federal portion of such funds—applies to the instant claims. However, unlike the posture of our letter of June 2, we are required by virtue of your submission to pass upon the merits of these claims. The facts presented with respect to the instant claims also differ from those considered in our letter of June 2 since it appeared in the latter context that both Tennessee law and Federal regulations required that the Federal funds there involved be maintained in separate accounts. On the other hand, there is no indication in the files transmitted here of any obligation on the part of the States to maintain separate accounts of section 221 payments; nor is there any indication that the actions of the States in commingling section 221 payments with other funds was improper in any respect. While we have held that failure to require segregation of Federal payments does not constitute waiver of a claim for interest as a matter of law, B-152505, January 30, 1964, this factor does, of course, affect the factual basis of such a claim. A-46031, July 25, 1941.

Turning to the circumstances presented with respect to the instant claims, it seems clear that, in the absence of any indication of dereliction or impropriety on the part of the States in commingling section 221 payments, the Federal Government must assume the burden of establishing a factual basis for attributing interest earned on State funds generally to such payments. This is true even if the States are to be regarded as "trustees" of such payments. Cf., 45 Am. Jur. 2d, Interest and Usury, section 44, page 47. Since these commingled payments have lost their identity, there is obviously no direct evidence in this regard. On the other hand, we believe that the previously quoted responses submitted to HEW by each of the three States here involved may fairly be read to express the position that, as a matter of State policy, section 221 payments are not invested in interest bearing accounts. The only rebuttal offered by HEW is that in the case of New York, State officials omitted certain Federal funds from calculations showing that total funds held in noninterest bearing accounts always exceeded total Federal payments held by that State. Apart from the fact that the specific nature of the omitted Federal payments is not disclosed, this is at most a minor inconsistency insufficient to justify the conclusion that the New York officials' statement as to the general nature of its fiscal policies is incorrect.

In view of the foregoing we conclude that the facts presented are insufficient to establish any liability on the part of the three States for the repayment of interest allegedly earned on section 221 payments; and we return herewith the case files without action.

In closing, we note that the procedures which gave rise to the instant matter have apparently been altered since 1965 by the utilization of letters-of-credit in lieu of actual advances of section 221 payments, thereby minimizing the loss of interest to the Federal Government. See Treasury Department Circular No. 1075; 31 CFR, Part 205. The advantages of this approach were recognized in the Senate report on the Intergovernmental Cooperation Act, S. Rept. No. 1456, 90th Cong., 2d sess., page 15. Accordingly, it appears that this problem will not be a recurrent one.

Sincerely yours,

R.F.KELLER

Deputy Comptroller General
of the United States

Enclosures

The Honorable
The Secretary of Health, Education,
and Welfare