ADMINISTRATIVE PROCEEDING
IN THE
UNITED STATES DEPARTMENT 0F EDUCATION

IN THE MATTER OF THE

AUDIT APPEAL OF

CALIFORNIA STATE UNIVERSITY AND COLLEGES

DECISION

BY PAUL S. CROSS, ADMINISTRATIVE LAW JUDGE

INTRODUCTION

This matter began on September 21, 1988, when the Chancellor of the California State University and Colleges (CSUC) System requested a review of the Financial Management Service's (FMS's) final audit determination that 19 CSUC institutions owe the Department 0f Education (ED) interest earned on Pell Grant Funds. The final audit determination concluded that the 14 CSUC institutions which were audited must pay ED $534,329 in interest earned on Pell Grant Program funds drawn down by the institutions during the audit period of July 1, 1983, through May 31, 1986. The final audit determination also directed the five CSUC institutions not audited by ED to determine the amount of interest, if any, earned on Pell Grant funds during that period and to pay any such interest to ED. CSUC submitted an initial brief on January 4, 1989, and FMS responded on February 24, 1989. CSUC filed a reply brief on March 10, 1989, and FMS filed a response on March 23, 1989.

The briefing schedule was established by an order of Administrative Law Judge Walter J. Alprin dated November 17, 1988. Judge Alprin no longer is available to decide this case. I am designated as his replacement.

CONTENTIONS 0F THE PARTIES

CSUC argues that under the Intergovernmental cooperation Act (ICA), 31 U.S.C. § 6501, et. sea., CSUC institutions are not liable for repayment of interest earnings. CSUC also argues that the evidence submitted with its initial brief should be considered in this proceeding. Finally, CSUC argues, among other things, that there were no interest earnings and that the absence thereof excuses payment 0f interest on Pell Grant funds to ED.

In reply, FMS argues that Pell Grants are direct grants from the Federal Government to students and are not grants to States or educational institutions. FMS, thus, argues that Pell Grant Program funds are not "grant" funds under the ICA because they are not allotted to a State or to a beneficiary under a plan or program administered by a State. FMS notes that the Pell Grant Program is authorized by section 411(a) of the Higher Education Act 0f 1965, as amended (HEA), 20 U.S.C. § 1070a, and is implemented by ED's regulations at 34 C.F.R. Parts 668 and

690. FMS asserts that both the statute and ED's implementing regulations make fit clear that Pell Grants are direct grants from the Secretary of Education to eligible students and are not grants to States or institutions such as the CSUC institutions.

FMS points out that former section 411(a) (1) (A) 0f the HEA which applied during the audit period specifically provided that "The Secretary shall ... pay to each eligible student ... a basic grant in the amount for which the student is eligible ...." 20 U.S.C. § 1070a(a) (1985). FMS says that CSUC cannot point to any language in this on any other statutory provision applicable to the Pell Grant Program that provides for a grantee role for institutions. Instead, FMS says that the institutions participating in the Pell Grant Program act only as disbursing and administering agents for the Department. The institutions are said to receive Pell Grant funds solely to disburse those funds to students attending the institution who the Secretary has determined are eligible for Pell Grants and the institutions hold those funds in trust for the students, citing § 411(c) of the HEA, 20 U.S.C. § 1070a(c), 34 C.F.R. §§ 668.22, 690.74, 690.81 (1986). FMS further says that the institutions participating in the Pell Grant program do not apply for Pell Grants or take other actions characteristic of a grant recipient, that the institutions do not have any discretion in administering the Pell Grant Program and that they act only as conduits to ensure that the Pell Grant funds flow from the Secretary to eligible students. In fact, FMS urges that section 411 states that § 411 (a) (1) is a "disbursement system" for the transmittal of funds from the Secretary to students and indicates that the institution acts solely as a disbursing agent. 20 U.S.C. § 1070a(a)(20)

FMS also argues that Pell Grant funds are not funds paid to a beneficiary under a plan or program administered by a State. The ICA, at 31 U.S.C. § 6501(4), defines "grant" as:

money ... that is paid or provided by the United States Government under a fixed annual or total authorization to a State, to a local government, or to a beneficiary under a plan or program administered by a State or a local government that is subject to approval by a executive agency, if the authorization -

* * *

(ii) specifies directly, or establishes by means of a formula, the amount that may be provided to the State or local government, or the amounts to be allotted for use in each State, by the State, local government, and beneficiaries.

FMS argues that Pell Grant funds do not satisfy the ICA"s definition of grant because Pell Grant funds assertedly are not allotted to a State pursuant to a formula.

FMS argues that in order to satisfy the ICA's definition 0f "grant," Federal money must: (1) be provided to a State, or (2) be provided to a local government; or (3) be provided to a beneficiary under a State or local government administered plan or program that is subject to approval by an executive agency. FMS dismisses CSUC claims that Pell Grant funds are provided to States or, alternatively, to beneficiaries under a State administered plan, and basically asserts, as noted earlier, that the Pell Grant Program provides direct grants from the Secretary of Education to students and not to institutions or States and that the Pell Grant Program is administered by ED

and not by States. Somewhat inconsistently, FMS also says that each CSUC institution administers the Pell Grant Program only for its own institution and not for other public or private institutions in California.

FMS also asserts that CSUC evidence to the effect that ED's calculation of interest earned on Pell Grant funds is incorrect, cannot be considered. FMS argues that 34 C.F.R. § 668.116(e) (l) requires that particular evidence be provided to ED at the time review of the final audit determination is requested.

When 34 C.F.R. § 668.116 was published as a final rule on August 12, 1987, the Secretary indicated that the regulations "take effect either 45 days after publication in the Federal Register, or later, if Congress takes certain adjournments. 52 Fed. Reg. 30114 (August 12, 1987). The regulations became effective on September 25, l987, although they did not appear in 34 C.F.R. until February 3, 1988. The final audit determination in this case was not issued until August 5, 1988.

In this situation, FMS asserts that CSUC should not be allowed to escape application of ED rules.

FMS also argues that even if the records in Exhibit A to CSUC's first brief are properly submitted, they do not demonstrate that the CSUC institutions earned less than $534,329 in interest during the audit period.

FMS finally argues that there is no estoppel in this case. CSUC claims that because ED did not previously demand payment of interest earned on Pell Grant program funds, it cannot do so now. However, FMS says that the Comptroller General has consistently ruled, for over 60 years, that recipients of Federal grant funds are responsible for returning interest earned on those funds to the Federal government.

STATEMENT OF FACTS

The Financial Management Service (FMS) of the Department of Education (ED) sent a final audit determination dated August 5, 1988, to the Chancellor of the California State University and Colleges (CSUC) System. The final audit determination was based upon an audit performed by the ED Office of Inspector General (OIG), and the resulting audit report, ACN: 09-60300, dated February 2, 1987.

The auditors reviewed the Pell Grant Program administration of 14 of the 19 institutions in the CSUC System for the period of July 1, 1983 through May 31, 1986. The auditors found that under their method of computation interest had been earned on Pell Grant Program funds during the period between the institutions' receipt of those funds from ED and the institutions' disbursement of those funds to students as Pell Grants.

In the final audit determination, FMS notified the Chancellor of CSUC, as the administrative head of the system, that these 14 institutions had to pay ED $534,329, representing the interest said to have been earned on Pell Grant Program funds drawn down by these institutions during

the period of July 1, 1983 through May 31, 1986. The final audit determination also directed the five CSUC institutions not included in the audit to determine the amount of interest, if any, earned as a result of similar draw downs during that period, and to repay any such interest to ED.

On September 21, 1988, the Chancellor of the CSUC System, on behalf of the 19 institutions, requested a review of the final audit determination under section 487(b) of the Higher Education Act of 1965 as amended (HEA), and the regulations published to implement that section, Subpart H of the Student Assistance General Provisions regulations, 34 CFR Part 668, Subpart H. Under those provisions, an institution may request that the Secretary review a final audit or program review determination of its administration of the student financial assistance programs authorized by Title IV of the HEA (Title IV, HEA Programs).

The CSUC System.

The California State University and Colleges (CSUC) System includes 19 separate public colleges and universities in the State of California. The fourteen institutions that were audited include: California State University, Chico; California State University, Fresno; California State University Fullerton; California State College, Hayward; Humboldt State University; California State University, Long Beach; California State University, Los Angeles; California State University, Northridge; California State Polytechnic University, Pomona; San Diego State University; San Francisco State University; San Jose State University; California State Polytechnic University; San Luis Obispo, and Sonoma State College.

The five unaudited institutions include: California State College, Bakersfield; California State University, Dominquez Hills; California State University, Sacramento; California State College, San Bernadino; and California State College, Stanislaus.

Title IV, HEA Program

The Title IV, HEA student financial aid program involved in this appeal is the Pell Grant Program.

For the audit period, the Pell Grant Program was authorized under Title IV-A-1 of the HEA, 20 U.S.C. 1070a (1985). The Pell Grant Program regulations were codified in 34 CFR Part 690 (1986). Under the Pell Grant Program, the secretary of Education provided and provides grants to eligible, financially needy students attending eligible institutions of higher education to help them pay for their postsecondary educational costs. The size of a student's Pell Grant was and is based upon strict statutory and regulatory formulae. For the audit period, see 20 U.S.C. 1070a(a) and 34 CFR Part 690, Subpart E. If funds were appropriated for the Pell Grant Program for a particular award year, an eligible student was entitled to receive a Pell Grant in an amount determined under the above statutory and regulatory provisions.

During the audit period, an eligible institution participated in the Pell Grant Program by entering into a program participation agreement with the Secretary. 20 U.S.C. 1094(a), 34 CFR 690.72. Under the agreement, the institution would be responsible for determining whether a student was eligible to receive a Pell Grant, and the amount of any grant. 34 CFR 690.75. The institution also

disbursed the Pell Grant to the student. 34 CFR 690.76 and 690.78. ED would provide Pell Grant Program funds to the institution to enable fit to make those disbursements based on the Secretary's determination (estimate) of the institution's need for funds to pay Pell Grants. 34 CFR 690.74.

During the audit period, an institution participating in the Pell Grant Program received Pell Grant funds from ED in the following manner. At the beginning of each award year, 1 ED sent the institution a Pell Grant authorization letter which established the maximum amount of funds that the institution could request from ED for Pell Grants for the award year. The amount was based upon the amount of Pell Grants the institution was expected to disburse during the first academic period of the award year. ED would increase the amount during the year on the basis of the institution's submission of documents to ED during the year. 2

During the audit period, each of the 19 institutions of the CSUC System received the estimated Pell Grant funds from ED under the Letter-of-Credit Payment system. Under that system, a letter of credit for each of the 19 institutions was established in the Federal Reserve Bank serving the area in which the institution was located. When the institution needed Pell Grant funds to make a disbursement to a student, it withdrew those funds from the Federal Reserve Bank using its letter of credit. Thus, the Pell Grant Program funds were often but not always almost immediately available to the institution. As such, institutions using the Letter of Credit system were admonished to draw down only those Pell Grant Program funds that were needed to pay Pell Grants to students during a three to five day period.

During the audit period California law required that all Federal funds, including Pell Grant funds provided by ED to each of the 19 CSUC institutions, had to be deposited by each institution into the State Treasurer's Federal Trust Fund Account. The purpose of this procedure was to enable the State Controller to keep an accurate account of all Federal funds received by the State. The institution recovered these funds by presenting a claim to the State Treasurer. Pell Grant funds thus recovered were then deposited into the institutions's Agency Bank Account at the State Treasury. It is from this account that Pell Grant disbursements were made. 3

ED's OIG in Region IX conducted a review of the treatment of the interest earned on Pell Grant Program funds held by 14 CSUC institutions for the period of July 1, 1983 through May 31, 1986. The audit was performed during the periods of January to July 1985 and June to August 1986, and its purpose was to determine the amount of interest earned on Pell Grants funds and whether that interest had been properly remitted to ED. The auditors performed a limited review of the student financial aid accounting systems at the institutions they visited. For the remaining institutions included in the audit, the auditors relied upon the review of internal controls performed by the institutions' Certified Public Accountants, whose workpapers were reviewed. Apparently, no workpapers were withheld and the auditors had open access to ail CSUC records.

The auditors found that fit was the practice of the CSUC institutions to deposit Pell Grant Program funds received from ED into the Federal Trust Fund Account. Once those funds were recovered by an institution, the funds would be deposited into the institution's Agency Bank Account. Funds deposited in the Federal Trust and Agency Bank Accounts were pooled and invested daily in a "Pooled Money Investment Fund" under the control of the Pooled Money

Investment Board. The assets in the Fund earned interest and, as required by State law, the interest earned by those investments was credited to the State's General Fund. See Cal. Gen. Code §16305.5 and §16305.7. Thus, the State retained interest earnings on Federal Pell Grant Program funds drawn down by the institutions solely for the purpose of paying Pell Grants to eligible students at those institutions.

The OIG auditors found that Federal Pell Grant Program funds were maintained on deposit by California for periods ranging from 3 to 72 days, during which time the funds earned interest. To determine the amount of interest earned by those Federal funds, the auditors used the average monthly earnings rate of the State's Pooled Money Investment Fund, which ranged from 8.37 to 11.68 percent during the audit period of July 1, 1983 to May 31, 1986. The amount of funds considered available for investment was adjusted for the amount of funds the State Treasurer's Office maintained as a compensating balance on which interest was not earned. The auditors multiplied the applicable interest rate times the recorded month-end cash balances maintained by the institutions. Using this procedure, the OIG auditors determined that $534,329 of interest was earned on Pell Grant Program funds said to have been drawn down by the institutions earlier than needed for disbursements as Pell Grants to students. The audit report is part of the record of this proceeding as Govt. Exh. 2.

The audit report was sent to the Chancellor of CSUC on February 2, 1987. CSUC officials did not agree that the funds were owed to ED and in responding to ED raised many of the same claims raised in their brief in this case. CSUC fully staked out its position and kept itself open for further examination by FMS ED considered CSUC's comments but conducted no further audit. In a letter dated August 5, 1988, the Director of ED's Financial Management Service sent CSUC the final adverse audit determination that is at issue in this case.

DISCUSSION AND CONCLUSIONS

Section 668.116(d) of the Student Assistance General Provisions regulations, 34 CFR 668.116(d), provides that

(d) An institution requesting review of the final audit determination or final program review determination issued by the designated ED official shall have the burden of proving the following matters as applicable--

(1) That the expenditures questioned or disallowed were proper;

(2) That the institution complied with program requirements .

CSUC contends that even if the 14 CSUC institutions earned $534,329 in interest on the Pell Grant Program funds they drew down from ED, they are not liable to pay that interest to ED under the Intergovernmental Cooperation Act, 31 U.S.C. 6503(a). CSUC also contends that the CSUC institutions do not have to repay the interest in dispute since they were not aware of the legal requirement to repay interest on Federal funds. Finally, CSUC argues that ED incorrectly determined the amount of interest on the Pell Grant funds. In reply DE asserts that CSUC has the burden of proving each of these contentions under the foregoing regulation which was adopted

after the occurrence of the events giving rise to instant proceeding. As will be shown, with or without the burden of proof herein, CSUC demonstrates that no interest is owed to DE for Pell Grant funds during the audit period.

The Comptroller General had consistently ruled since 1922 that interest earned on Federal funds by a grantee must be returned to the Federal Government when the interest is earned during the period between the draw down of those funds from the Federal Government and the expenditure of those funds under the program for which they were drawn down. See, for example, 64 Comp. Gen. 96 (1984); 62 Comp. Gen. 701 (1982); 42 Comp. Gen. 289 (1962); 1 Comp. Gen. 652 (1922). In recognition of this principle, and to give States limited relief from this requirement, Congress enacted the Intergovernmental Cooperation Act, 31 U.S.C., 6501 et seq (ICA) in 1968.4 One section of the ICA, 31 U.S.C. 6503(a), provides that:

. . . A State is not accountable for interest earned on grant money pending its disbursement for program purposes.

In determining whether 31 U.S.C. 6503(a) applies to this case, two questions need to be resolved. They are whether the 19 CSUC System institutions qualify as a "State" for purposes of 31 U.S.C. 6503(a), and whether Pell Grant Program funds disbursed to those institutions are "grant" money under that section.

There can be no genuine doubt that the Pell Grant funds were provided to the State of California. Indeed, it is that fact which gives rise to the current dispute, that is whether the State's University should be liable for grant monies held pending disbursement .

As the FMS brief correctly states the grant monies are paid to CSUC institutions which are part of the State of California.

The term "State" is defined in 31 U.S.C. 6501(8) while the term "grant" is defined in 31 U.S.C. 6501(4). The 19 CSUC System institutions demonstrate that the 19 institutions qualify as a "State" under the definition of the term "State" set out in 31 U.S.C. 6501(8). Further, the 19 CSUC System institutions demonstrate that Pell Grant Program funds qualify as "grant" money under the definition of the term "grant" in 31 U.S.C. 6501(4).

In order for the provisions of 31 U.S.C. 6503(a) to absolve the 19 CSUC System institutions from repaying any interest earned on the Pell Grant funds they drew down from ED, they must qualify as States. The term "State" is defined in 31 U.S.C. 6501(8) as

[A] State of the United States, the District of Columbia, a territory or possession of the United States, and an agency or instrumentality of a State but does not mean a local government of a State.

When this definition was originally enacted as part of the ICA, both of the pertinent House and Senate Committee Reports stated that the Act defines the term "State" as that term is usually found in most Federal statutes, with the exception that fit does not include governments of the political subdivisions of the State. See H.R. 90-1845, 90th Cong. 2d Sess., p. 4 (1968); S. Rpt.

90-1465, 90th Cong., 2d Sess., p. 12 (1968). However, this definition of a State is much broader than the one used under most education statutes such as the HEA where a State is defined as one of the several States or a particular geographic entity such as Guam or Puerto Rico. See for example, section 1201(b) of the HEA, 20 U.S.C. 1141d(b).

The 19 CSUC System institutions are clearly not one of the States of the United States nor a territory or possession of the United States. Thus, they may be considered a State only if they qualify as a State agency or instrumentality. However, the 19 CSUC institutions demonstrate that as public colleges or universities in California each is a "State agency" or "State instrumentality" under California law. Accordingly, the record in this case supports a finding that the 19 institutions qualify as States under 31 U.S.C. 6501(8).

Even assuming the Pell Grant monies were not "paid or provided by the United States Government . . . to a State," they were provided "to a beneficiary under a plan or program administered by a State . . . that is subject to approval by an executive agency . . . ." If FMS views the ultimate beneficiaries, the students, as the recipients of the grant funds, such an arrangement would also come within the definition of "grant" monies. Clearly, the institution, the State University, which administers the program is approved by an executive agency, the Department of Education, in order to participate in the Pell Grant Program The execution of Program Participation Agreements between each California State University institution and the Secretary of the Department at all times pertinent to this audit is evidence of this fact. The record establishes that those agreements and the instructions that accompany them are extremely detailed and place great administrative burdens on the State.

Under 31 U.S.C. 6501(4)(A), a grant is defined as:

money. . . that is paid or provided by the United States Government under a fixed annual or total authorization to a State, to a local government, or to a beneficiary under a plan or program administered by a State or a local government that is subject to approval by a executive agency, if the authorization--

(i) requires the State for local government to expend non-Government money as a condition of receiving money or property from the United States Government; or

(ii) specifies directly, or establishes by means of a formula, the amount that may be provided to the State or local government, or the amounts to be allotted for use in each State by the State, local government, and beneficiaries . 5

As noted earlier, the Pell Grant Program is one of the student financial assistance programs authorized under Title IV of the HEA. A student's Pell Grant is made Up entirely of Federal funds and institutions are not required to spend non-Pell Grant Program funds as a condition of receiving Pell Grant Program funds. See 34 CFR 690.74. Accordingly, Pell Grant Program funds do not qualify as "grant" funds under subsection (i) above since States or institutions 6 at which students are enrolled are not required to expend non-government funds as a condition of receiving Pell Grant funds to disburse to students. However, subsection (ii) above is the relevant statutory provision, not subsection (i) .

Further, in this regard, even though FMS asserts that no formula is involved in computing the amount of Pell Grant funds allotted to the State, the Federal statutes, however, belie such an assertion. Congress has demonstrated great care in setting out with specificity the base for computing the amount of Pell Grant monies which may be awarded and thus the amount that may be provided to a state university for its eligible students. A review of the pertinent provisions of Section 1070a as these provisions have changed over time provides impressive proof of this fact (see, for example, the Education Amendments of 1980, P.L. 96-374, 94 Stat. 1367, 1401-1403; and the Student Financial Assistance Technical Amendments Act of 1982, P.L. 97-301; 96 Stat. 1400-1403). That the formula speaks in terms of amounts that may be awarded to ultimate recipients of the grants makes it no less a formula. The statute with no small attention to detail sets the amount that may be awarded which the United States Government distributes to the institutions of the California State University. The United States Government does not arbitrarily set an amount and distribute it. It is established by a process or formula prescribed by statute, and DE further refines this process again by formula. Finally, the State is charged with responsibility for applying the formula.

Under the Pell Grant Program, the Secretary of Education provides grants to financially needy students who are enrolled in any one of approximately 6000 eligible institutions of higher education to help the students pay for the costs of their postsecondary education. If funds are appropriated for the Pell Grant Program for a particular award year, an eligible student as noted, is entitled to receive a Pell Grant in an amount determined under strict statutory and regulatory formulae. ED provides funds to the institutions at which the students are enrolled so that the institution can provide Pell Grants to eligible students according to a formula. See 34 CFR 690.74. It is true that the eventual amount of Pell Grant Program funds an institution receives depends on the amount of funds for which its students are eligible. However, even then initial funds received by the State are the result of DE estimate.

Thus, as can be seen from the above description, Pell Grant Program funds do qualify as "grants" under the definition of that term in 31 U.S.C. 6501(4) (ii) because the Pell Grant Program funds are based upon formula. Stated differently, the amount of Pell Grant Program funds to be provided to a State or institution on behalf of its students is established by means of a formula, and the funds are allotted under the Pell Grant Program to a beneficiary under a program co-administered by ED and the state or institution.

CSUC also refers to the current version of section 411(a) of the HEA, 20 U.S.C. 1070(a), to support its contention that Pell Grant funds are "grant" money as that term is defined in 31 U.S.C. 6503(4) (A) (ii).

The audit period in this proceeding is July 1, 1983 through May 31, 1986. The current version of section 411(a) of the HEA cited by the CSUC system reflects the changes made to that section by the Higher Education Amendments of 1986, Pub. L. 99-498. The Higher Education Amendments of 1986 were signed into law on October 16, 1986, and this section became effective on that date. 7 Therefore, this section, enacted more than four and one half months after the end of the audit period arguably has no bearing on this case. similarly, it may be argued that regulations (CFR's) adopted after the audit period have no bearing on this case. However, these

issues need not be reached became even under the old law and the new regulations, it is concluded that respondents' position is supported by the facts of record .

During the audit period, section 411(a) (1) (A) of the HEA provided that

The Secretary shall, during the period beginning July 1, 1972, and ending September 30, 1992, pay to each eligible student (defined in accordance with section 484) for each academic year during which that student is in attendance at an institution of higher education as an undergraduate, a basic grant in the amount for which the student is eligible, as determined pursuant to paragraph (2). 8

This provision that "basic" Pell Grants are made by DE's Secretary to eligible students by itself provides no basis for determining that Pell Grant funds are "grant" money under 31 U.S.C. 6501(4) (A) (ii) but it does not stand alone. 9 It is true that new prompt payment techniques have helped in grantees limiting the amount of funds they draw down in advance of disbursement and have reduced the number of days between draw down and disbursement. However, this was not true for the period covered by the audit. Negative cash balances predominate over positive cash balances. In terms of interest lost to the State of California because of the predominance of negative cash balances, the Department of Education should reimburse the State of California $22,000 in lost interest for the 13 month period covered by the data. Clearly, the State was not unjustly enriched by the Pell Grant funds.

FMS discounts entirely the negative cash balances. It argues: (1) no law requires deficit spending, (2) the California State University cannot prove deficit spending was necessary, and (3) the California State University provides no evidence that its deficit spending was authorized by law. However, inconsistently, FMS views change when it comes to the treatment of positive cash balances concerning which the California State University argues (1) no law requires repayment of theoretical lost interest and (2) Department of Education has not proven misfeasance or malfeasance. It is indeed just such squabbles between the Federal government and the 50 states that Congress sought to stop in the Intergovernmental Cooperation Act.

FMS seeks to avoid uncontroverted and uncontrovertible evidence that CSU is not liable in the amount of $534,329. FMS cites a rule which prohibits "new" evidence. However, the rule is only an internal procedure presumably designed to "weed out" tardy arguments that lack merit.

As alluded to, CSUC's position is supported by an abstract listing the daily cash balances of CSUC campuses. This abstract is submitted with its initial brief. See Exhibit A to CSUC's brief.

Under section 668.116(e) (1) of the Student Assistance General Provisions Regulations, 34 CFR 668.116(e) (1), an institution may submit underlying documents in an audit appeal proceeding which previously or concurrently are available to DE. Section 668.116(e) (1) states, in pertinent part:

A party may submit as evidence to the administrative law judge only materials within one or more of the following categories.

(ii) Institutional audit work papers, records and other materials, if the institution provides those work papers, records or materials to ED no later than the dated by which it was required to file its request for review . . . (emphasis added)

CSUC submitted the abstract based on records which were available or provided to DE during the audit. In fact, DE elected to look only at certain limited monthly figures, even while noting that there were deficits under a separate method of interest computation. See page 6 of OIG audit report dated February 2, 1987, which is attached as Exhibit 2 of FMS's opening brief. DE cannot complain now that the abstract is unsupported. Indeed, the abstract is not even an underlying work paper, record or material under 34 CFR 668.116(e) (1) (ii). 10 Instead, it has been prepared from such material which was available to FMS, but was eschewed on grounds of relevance. As a matter of fact, as to five of the subject State institutions, FMS looked at no records and would have CSUC itself do the accounting work. Therefore, the abstract, since it is based on records previously available and in fact information noted by DE, the abstract must be considered in this proceeding. CSUC, more importantly, also shows that the accounting procedure used by OIG is incorrect. 11

CSUC properly complains that the auditors incorrectly refused to allow a credit for '"negative cash balances caused by the institutions' payment of Pell Grant funds to students entitled to the receipt of Federal funds. CSUC also shows that its payments to students were necessary to meet Pell Grant program requirements.

In this regard CSUC correctly shows that such CSUC spending was necessary to meet the purposes of the Pell Grant Program, because required Federal funds were not always provided on a timely basis CSUC shows that there were delays in actually receiving the wire transfer of Federal funds under the letter of credit system. This was not deficit spending, but rather was a flawed electronic process occasioned by DE inadvertence. Further, CSUC as co-administrator of the Pell Grant Program is not empowered to withhold funds from eligible students. Thus, CSUC does not owe ED $534,329 of interest on Pell Grant Program funds.

OVERVIEW

After the February 2, 1987, audit report of OIG, a chronology shows that there was one and one half years of no action by FMS on the matter CSUC hoped that DE was not going to pursue the matter Meanwhile, different rules governing the process emerged: first, audit appeal procedures became effective on September 26, 1987, then on February 3, 1988 an amended 34 C.F.R. 668.13, now codified as 34 C.F.R. 668.24, spoke for the first time referencing the audit appeal procedures.

Not until February 3, 1988, over 15 months after the CSUC and the Department began a process of discussion toward an informal resolution of the matter, were appeal procedures referenced in the 34 CFR section of the Student Assistance General Provisions (Part 668) which addresses "audit exceptions and repayments."

A parallel matter, involving interest from NDSL draw downs (Audit Control No. 09-50281) was resolved between the CSUC and the Department on May 3, 1988. The same procedure that had

resulted in the NDSL interest resolution was also being pursued -with regard to Pell Grant interest. Then DE changed its review procedure and set a matter which was years old within a procedure which was months old.

Apart from the prior DE practice of ignoring the matter of interest, there was uncertainty concerning the effect of the ICA On February 10, 1987 the Office of Management and Budget issued a "Final Revision to Circular A-110 'Uniform Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and other Nonprofit Organizations"' (52 Federal Register 4240). The revision, applicable to the Pell Grant monies, amended the OMB's 1976 version stating in its summary:

"This revision provides that recipients shall maintain advances of Federal funds in interest bearing accounts. Interest earned on Federal advances deposited in such accounts shall be remitted promptly to the Federal agencies that provided the funds." (Ibid.)

This represented a change. Circular A-110 during the audited period contained no such requirement. The change in Circular A-110 was "effective immediately," that is, February 10, 1987. Publishing the comments received, OMB stated:

"Comment: The proposed revision is not clear as to whether State universities, covered by Circular A-110, will be required to remit interest income to the Federal Government. "Response: Section 203 of the Intergovernmental Cooperation Act of 1968; 42 U.S.C. 34213 (1976) provides that States and their instrumentalities generally are not accountable for interest earned on grant-in-aid funds. Therefore, State universities that are instrumentalities of a State would not be subject to the proposed revision." (52 Federal Register 4240-4241)

OMB's response appear to reflect an understanding that, together with the Department's assenting over time to CSU's treatment of interest, the State of California was not liable to the Federal government for any interest that might be generated pending disbursement of Title IV funds.

It is clear that at all times pertinent to the time period of the audit, the program participation agreements between each of the 19 California State University institutions and DE were silent as to any liability with regard to interest. Not until 1987 did the program participation agreements for the first time include a provision addressing treatment of interest. Similarly, no statute or regulation referred to in the program participation agreements addressed such liability. FMS cites 34 C.F.R. 668.11 and 668.22 which were operative during the audited period. These regulations, however, do not require repayment of any alleged interest earnings. Section 668.11 provided, in pertinent part"

"This agreement (the program participation agreement) conditions the initial and continued eligibility of the institution to participate in the title IV student assistance programs upon compliance with the provisions of this part and the individual program requirements."

Nothing in "this part," referring to Part 668, the Student Assistance General provisions, nor the Pell Grant provisions refer to the responsibility of participating institutions to return interest on Pell Grant funds pending disbursement. Section 668.22 provided, in pertinent part:

"[Funds received by an institution under the Pell Grant program, among others,] are held in trust for the intended student beneficiaries. The institution, as a trustee of Federal funds, may not use or hypothecate (i.e., use as collateral) title IV funds for any other purpose."

The institutions of the CSUC have honored this provision and have not used Pell Grant Program funds or any other Title IV program funds for any purpose other than for appropriate financial aid for the intended student beneficiaries. These funds have not been used as collateral to obtain loans or for any other purpose not appropriated to the program.

Nothing in these provisions state that interest must be returned to the Department of Education when interest is lost through spending required to administer the program Thus, despite FMS's assertion (FMS Brief, pp. 19-20) no contractual provision nor pertinent regulation addressed the matter What is clear, however, is that the practice between participating institutions and DE was to not assess interest which may have been earned pending disbursement of funds.

FMS correctly states that CSUC may not avoid liability to the Department based on its lack of knowledge. While ignorance of the law is no excuse, it is clear that where there is no duty in statute, regulation, or contract and where there is a past administrative practice which has not imposed liability, DE as lead administrator of the Pell participants has a duty to inform the co-administrators of their legal responsibility. DE clearly breached its duty to the program participants to alert them to this obligation. If as FMS asserts (FMS Briefs, p.20) there was a "long standing rule" making program program participants "responsible for returning interest assertedly earned on those funds to the Federal Government," the Department had a duty to inform program participants of that responsibility and to evenly and consistently enforce that rule among program participants. If there was such a "long standing rule," DE for many years did not enforce it. Nor is there any indication that DE has evenly enforced its new rule among program participants.

The treatment of interest which has been recently added to the program participation agreement signals a change in practice and policy. CSUC now may have a future legal obligation. With a policy change and an agreement of institutions to be bound by that policy, DE would have an adequate legal basis to assess liability. No such basis existed during the audit period involved in this case.

FINDINGS AND ORDER

The ED final determination letter and OIG audit report included in the record of this proceeding that the CSUC institutions improperly failed to pay ED $534,529 in interest on Pell Grant funds is erroneous. Therefore, the final audit determination ordering the CSUC institutions to pay the ED $534,529 is vacated. The final audit determination ordering 5 CSUC institutions to calculate the interest on Pell Grant Program funds during the audit period and return that amount to ED also is vacated.

In the absence of a timely appeal or timely action by ED on its own motion, this order will become effective as the order of the Department of Education.

By Paul S. Cross, Administrative Law Judge on November 28, 1989.

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1 An award year is the twelve month period from July 1 of one year through June 30 of the following year. 34 CFR 668.2.

2 A description of this process is contained in the official ED publication, "A Self-Instructional Course in Student Financial Aid Administration, Module 14, Authorization, Fiscal Operations, & Reporting" attached as Government Exhibit (Govt. Exh.) 1. See, in particular, section 14.1. While this publication provides instructions for the 1988-89 award year, comparable procedures were in place for the 1983-86 audit period. The instructions are extremely complicated and plainly require a huge administrative investment by the institutions. It is clear that the Pell Grant Program would fail without the detailed administrative functions of the institutions.

3 FMS asserts that the result of these procedures was that the CSUC institutions drew down Pell Grant Program funds much earlier than needed to make Pell Grant disbursements to students.

4 In reporting the bill which became the Intergovernmental Cooperation Act to the Senate, the Senate Government Operations Committee explained the reason for this provision as follows:

Decisions of the Comptroller General of the United States have in the past required that recipients of Federal grants return to the Treasury any interest earned on such grants prior to their use, unless Congress has specifically precluded such a requirement. The new techniques, such as the letter of credit and sight draft procedures now used by the Treasury, should minimize the amount of grants advanced, and thus it should not be necessary to continue to hold States accountable for interest or other income earned prior to disbursement.

5 The ICA also specifically excludes certain payments and property from the definition of "grant". See 31 U.S.C. 6501(4) (c).

6 As previously concluded, each institution is otherwise qualified as a State under the ICA.

7 See Section 2 of Pub. L. 99-498.

8 20 U.S.C. 1070a(a) (1985).

9 The current version of section 411(a) (1) (A) of the HEA under 31 U.S.C. 6501(4) (A) (ii), provides that 85 percent of the funds that an institution will need to disburse Pell Grant awards to students for a payment period will be provided to that institution before the beginning of that payment period. The section does not specify directly, or established by means of a formula, the amount to be provided to a State or an institution, or the amount to be allotted for use in each State or institution. Instead there is a formula based on student need. Also, DE uses a formula under its own guidelines. DE procedures presumably are lawful additions to the basic Pell program These procedures, as noted, include application of a formula at the beginning of each award year. They also include, as previously noted, detailed administration by the State agency,

without which the Pell Grant Program would fail. It thus, is clear that the Pell Grant Program is administered by the institution which in this instance are State agencies.

10 In the "Afterword" to its brief (pp. 17-19), CSUC expresses "concern" over the time deadlines for submission of evidence provided in ED's regulations CSUC also suggests that its individual circumstances made it impossible to include data in its request for review However, that CSUC was initially notified of OIG's finding on February 2, 1987, and had 19 months (until September 1988) to develop its evidence and submit it to ED. This it did without in any way exceeding the limitations on the admissibility of evidence in 34 CFR 668.116(e) (1) (ii).

11 The abstract in CSUC's Exhibit A demonstrates that the CSUC institutions did not earn $534,329 in interest during the audit period. The abstract covers only 13 months of the 35 months covered by the OIG audit, but the basic disagreement here is over the method of computation and not the underlying records which would have been fully available to DE should it have cared to look. If the underlying documents for ail of the 35 months are not now available, DE has no one to blame but itself. Moreover, there is every reason to believe that the 13 months are representative of the other 35. Indeed OIG itself concedes the existence of negative balances, but dismisses them upon the ground that Pell regulations do not require "deficit" spending. However, CSUC is not seeking reimbursement for deficit spending. It simply wants interest calculated to reflect the actual cash flow. Thus, the dispute here is not over records, but instead concerns the most realistic method of interest computation.