ACF Administration for Children and Families	U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES	
	1. Log No. ACF-PI-HS-09-07	2. Issuance Date: 05/12/2009
	3. Originating Office: Office of Head Start	
	4. Key Words: Accrued Leave	

PROGRAM INSTRUCTION

TO: All Head Start and Early Head Start Grantees

SUBJECT: Accrued Leave

INSTRUCTION:

There have been many questions asked by grantees, auditors and federal staff about how Head Start grantees should deal with the issue of accrued leave. The following questions and answers attempt to provide some clarity on this issue. The following guidance is based on Generally Accepted Accounting Principles, OMB instructions in this area and 45 CFR Part 74.21 and 45 CFR Parts 92.20 and 92.25.

1. ***Are non-profit grantees allowed to set-up "trust accounts," which are administered by third-parties, as a means of accounting for and distributing funds to employees entitled to accrued leave payments?***

   Yes. The practice of establishing "trust" accounts as a means of accounting for and distributing funds to employees entitled to accrued leave payments, in which a third party administers funds for future disbursement, is allowable. Such "trusts" or "reserves" must be paid to a trustee (or insurer) who maintains a trust fund or reserve for the **sole** purpose of paying the leave (and related fringe benefits) for which the reserve is established.

2. ***Are State and Local Governments allowed to use current year funds to pay for accrued leave obligations, i.e., "pay-as-you-go"?***

   Yes. It is allowable for those State and Local Governments to pay for accrued leave with current year funding (pay-as-you-go).

3. ***Are non-profit grantees allowed to use current year funds to pay for accrued leave obligations, i.e., "pay-as-you-go"?***

   Yes. It is allowable for non-profit grantees to pay for accrued leave with current year funding (pay-as-you-go). However, OHS believes that non-profits that do this, run a significant risk of experiencing cash shortfalls in any given budget year. Grantees should be aware that OHS will not provide a remedy for any grantee who has failed to properly account for, and plan for the payment of accrued leave to their employees. That is, any grantee unable to fully cover its accrued leave obligations will receive no additional funding from OHS to do so. Grantees are encouraged to give consideration to amending their personnel practices to limit the amount of accrued leave that is allowed to be carried over from one year to the next, thus limiting the potential for funding shortfalls.

4. ***Should accrued leave be reported as an expenditure or an unliquidated obligation for reporting purposes?***

For non-profits that establish trust funds or reserves, the SF-269 or other financial reporting form should be completed as if the leave expense occurred during the budget period for which the report is submitted. Financial statements should reflect the accrued leave liability and must carry them as such until the leave is actually paid.

Given the fact that the Financial Status reports (SF-269) and the agency financial statements might be different, depending how accrued leave is booked, grantees must maintain a detailed schedule reconciling the SF-269 reports and the agency financial statements.

5. ***If accrued leave is considered an expenditure, does the Federal government have the authority to tell the grantee how to maintain the funds or once funds are drawn for an allowable cost, is Federal control lost?***

The Federal government does not have the authority to tell a grantee how to maintain the funds. Nonetheless, the standards for financial management systems as articulated under 45 CFR 74.21 as well as 45 CFR 92.20 must be followed. Grantees should be cognizant of the fact that the practice of maintaining cash accounts under their control is examined closely during an audit. Expending these funds for purposes other than those for which they were intended is unallowable.

Grantees should also be aware that any account—either “internal” or “trust”— if over FDIC insurance limits, must be properly safeguarded through collateralization, the purchase of additional insurance, etc.

6. ***If accrued leave is considered an expenditure, can funds be drawn down prior to payment?***

Yes, these funds can be drawn down and maintained in separate “trust” or “reserve” accounts or maintained in a grantee’s payroll account.

If funds are held by the grantee, consideration should be given to establishing a separate payroll ledger and payroll bank account for the recording and payment of accrued leave. The payroll ledger and payroll bank account must be reconciled to the general ledger on a monthly basis.

The agency A-133 audit should identify the value of accrued leave (and attendant costs such as FICA) on the balance sheet and include an accrued leave note, in the notes to the financial statements. The note should reference the accrued leave balance (a liability) and the cash balance (an asset) associated with the accrued leave.

Grantees should be cognizant of the fact that the practice of maintaining cash accounts under their control, designated to pay accrued leave, is examined closely, given the possibility for an agency to expend these funds, which are readily available, for purposes other than those for which they were intended.

7. ***If funds are drawn down and held for future payment, is the grantee allowed to maintain those funds in an interest bearing account?***

   Yes. Grantees are, in fact, encouraged to establish an interest bearing “trust” or “reserve” account, as the interest earned would assist in offsetting some of the fringe benefit costs that increase over time. Grantees that are instead putting accrued leave obligations in a separate payroll bank account are also encouraged, for the same reason, to put these funds in an interest bearing account.

8. ***If there is flexibility for the grantee on how the funds are maintained, would interest earned on such funds be considered program income or an applicable credit?***

   Interest earned on funds deposited into a reserve paid to a trustee or into any other interest bearing account is not considered program income.

9. ***If I currently operate a “pay as you go” system, how can I switch over to a system of expensing the leave as it is earned, either through a trust fund or separate payroll ledger?***

   While there are a few ways to do this, ACF recommends the following approach:

   > You would record your pay-as-you-go obligations at the time you switch to an accrual system. You should then, as employees take leave, charge that leave against the employee’s pay-as-you-go balance, eventually reducing your pay-as-you-go obligations. Concurrently, you would be expensing that employee’s earned leave. At some point, likely within a few years, the employee’s pay-as-you-go balance will be reduced to zero and all of the employee’s leave will have been properly expensed.

10. ***If I use, say, a trust fund and expense leave as it is accrued, how do I assure the trust fund has sufficient funding to cover the costs of that leave which will, in most cases, be paid out to the employee at a higher rate than the rate at which it was earned?***

    Putting these funds in an interest bearing account will help offset at least part of these increased costs. In almost all cases, the trust fund should have enough funding to offset increased accrual costs. Should increased leave obligations result in this ever not being the case, any shortfall would need to be paid from funds awarded you for your current budget period.

Please direct any questions on this Instruction to your OHS Regional Office.

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