Department of Legislative Services

Maryland General Assembly
2023 Session

FISCAL AND POLICY NOTE
Third Reader - Revised

Senate Bill 112 (Senator Kagan)
Budget and Taxation Health and Government Operations

State Finance and Procurement - Grants - Prompt Payment Requirement

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This bill establishes that it is the policy of the State to make payment under specified grant agreements with nonprofit organizations within 37 days of (1) the payment becoming due under the grant agreement or (2) if later, receiving a proper invoice. Interest accrues at the rate of 9% per year on any amount for which a grant-making entity has received and failed to submit a proper invoice to the Comptroller within 30 days of its receipt. However, interest does not begin accruing until the thirty-eighth day after the grantor receives a proper invoice. **The bill takes effect June 1, 2023.**

Fiscal Summary

State Effect: General and special fund expenditures may increase by *up to* $8,100 in FY 2023 and *up to* $97,100 each year thereafter to pay interest on late payments to grantees. Additional expenditures for staff at grant-making agencies (to ensure on-time payments) are not anticipated unless interest payments exceed the cost of adding additional staff in agencies that award high volumes of grants, as discussed below. No effect on revenues.

Local Effect: None. The bill applies only to State grant payments to nonprofit organizations.

Small Business Effect: None. Nonprofit organizations are not considered small businesses.

Analysis

Bill Summary: A "grant" means a legal instrument of financial assistance between a State grant-making entity and a nonprofit organization that meets specified criteria. "Grant" does not include:

- grants executed, renewed, or extended before June 1, 2023;
- direct government cash assistance to an individual;
- a subsidy;
- a loan guarantee;
- insurance; or
- State funding that is required annually and is calculated through a formula set in statute.

Also, the bill does not apply to a unit in the Judicial Branch of State government or to grants funded from general obligation bond proceeds or from a general fund capital appropriation to the Board of Public Works.

A proper invoice must include without error (1) the grant recipient's federal employer identification number or Social Security number; (2) the grant agreement's identification number or other adequate description; and (3) any documentation required by regulation or the grant agreement.

The bill includes specified procedures for receiving and processing invoices from grant recipients to determine whether they are proper invoices. If an invoice is determined to be proper, the grant-making entity must submit the invoice to the Comptroller, who must pay the invoice within five business days. If the grant-making entity determines that an invoice is not a proper invoice, it must notify the grant recipient, within two business days of the determination, of all the reasons that the invoice is improper. Failure by the State grant-making entity to comply with these procedural requirements does not constitute a late payment.

Payment of interest is required only if a grant recipient submits an invoice for the interest within 30 days of the date on the State's check for the amount on which the interest accrued. Further, the State is not liable for interest (1) if the State has initiated legal proceedings to dispute the amount owed; (2) that accrues more than one year after the thirty-first day that the State receives an invoice; or (3) on unpaid interest. Interest for which a State grant-making entity is liable must be paid from the entity's operating budget and not from funds appropriated to fund a grant.

State grant-making entities may use media that produce tangible recordings of information to expedite the payment process rather than requiring paper documents. They must also provide adequate safeguards and controls to ensure the integrity of the data and to prevent duplicate processing.

The bill does not create liability on the Comptroller for interest accrued on a late payment.

Current Law: There are no requirements in statute related to the timing of grant payments. The bill's requirements related to the timing of grant payments and the accrual and payment of interest on late payments are modeled somewhat on requirements for payment under State contracts. It is the policy of the State to make payments under a procurement contract within 30 days of (1) the payment being due under the contract or (2) if later, receiving an invoice. In general, interest accrues at the rate of 9% per year on any amount that is due and remains unpaid 45 days after receiving an invoice; effective June 1, 2023, interest becomes payable after 37 days. Interest begins accruing on the thirty-first day after payment is due. Contractors must submit invoices for interest due, and interest is not payable (1) if a contract claim has been filed; (2) on interest that accrues for more than one year; and (3) on unpaid interest.

State Expenditures: In general, grantees submit invoices for payment to grant-making agencies, which review the invoices to ensure they are proper. Once grant-making agencies determine an invoice is proper, they forward it to the Comptroller's Office for payment. The Comptroller's Office asks agencies to allow 5 days for payment (giving agencies 25 days to review and approve a payment) but generally tries to process payments in 1 to 3 days. Thus, the bill affects both grant-making agencies with high volumes of grant awards and the Comptroller's Office.

The bill has two potential effects on State agency expenditures:

- State grant-making entities may need to hire additional staff to process grant payments to ensure that they are paid within 37 days; or
- State grant-making entities may become liable for interest on late payments.

As discussed below, the Department of Legislative Services (DLS) believes that State agencies likely opt to risk paying interest on late payments rather than increase staff to improve on-time payment performance.

Volume and Timing of Grant Payments

A November 2021 audit of grant awards by the Office of Legislative Audits (OLA) identified $5.0 billion in grant awards made by State agencies over a six-year period (July 1, 2014, through June 30, 2020). Of those, $3.7 billion were operating grants and $1.2 billion were capital grants. The bill excludes capital grants from the payment requirements, so this analysis is based on $3.7 billion in operating grant awards, or an average of $617 million per fiscal year (grants by the units of the Judicial Branch, which are also excluded from the bill, do not represent a meaningful portion of total grant awards).

A December 2022 study by DLS found that, from fiscal 2019 through 2022, between 97.6% and 96.1% of the dollar value of payments owed by State agencies were paid within 30 days (the data used for the study did not allow for a determination of the percentage of payments made within 37 days). The study does not distinguish between grant and contract payments, but there is no reason to believe that agency performance is substantially different for each type of payment.

Interest Accrual on Late Payments

For this analysis, DLS calculated the State's projected annual penalty interest liability based on the following assumptions:

- State agencies pay an average of $617 million in operating grants each year (based on OLA's 2021 audit);
- 3.0% of the value of grant payments by State agencies is paid late (adjusted from the findings of the DLS study to account for payments made after 37 days instead of 30 days);
- the value of late payments to grantees averages $18.5 million each year (3.0% of $617 million);
- 20.9% of late payments are made between 38 and 45 days, 13.3% are made between 46 and 60 days, and 29.2% are made after 60 days (based on fiscal 2022 results in the DLS study); the remaining 36.6% are delivered by agencies to the Comptroller's Office after the required 30 days (and, thus, are deemed late) but are paid before 38 days (so that no interest actually accrues); and
- payments made in the 38-to-45-day timeframe are paid on day 41; payments made in the 46-to-60-day timeframe are made on day 52; and payments made after 60 days are paid on day 90.

The bill requires that interest on late payments be charged at the annual rate of 9%, which translates to 0.025% per day. Based on this daily interest rate and the assumptions listed above, DLS projects that the State could be liable for $97,129 in annual penalty interest payments each year; this estimate may encompass grant payments made to entities other than nonprofit organizations. Accordingly, given the bill's June 1, 2023 effective date, the State's liability is *up to* $8,094 in fiscal 2023 (and then *up to* $97,129 each year thereafter). However, the State does not have to actually pay penalty interest unless a grantee submits an invoice for the amount of the penalty. The Comptroller's Office advises that State contractors virtually never submit such invoices; to the extent that grantees are similarly unlikely to submit invoices for penalty interest, State agency payments may be minimal. Any penalty payments may not be made from money reserved for grants, so any general or special fund expenditures used to pay interest must come from other budgeted sources.

Alternatively, agencies that award a high volume of grants may consider adding additional staff to ensure all payments are made on time. For instance, the Department of Natural

Resources advises as many as nine additional full-time staff at an annualized cost of more than $700,000 could be needed; the Maryland Department of Health advises as many as six additional full-time staff at an annualized cost of more than $650,000 could be needed. These projected costs far exceed the estimated annual costs of paying interest on late payments.

Thus, it appears to be more cost-effective for agencies to risk having to pay minimal interest penalties than to invest in increased staffing to improve on-time payment performance. To the extent that grant funding levels and/or on-time payment performance by agencies fluctuate, actual State liabilities for interest payments may be more or less. If actual interest payments ultimately exceed the cost of adding staff to process payments more efficiently, State expenditures (general and special funds) may increase accordingly to hire more staff. However, DLS does not anticipate this occurring.

Additional Comments: The Maryland Department of Transportation advises that some grants require submission of an annual report before payment is made, but the bill does not allow for any such conditions as long as grantees submit timely invoices.

Additional Information

Prior Introductions: Similar legislation has been introduced within the last three years. See SB 542 and HB 451 of 2022.

Designated Cross File: HB 328 (Delegate Kaiser, *et al.*) - Health and Government Operations.

Information Source(s): Department of Commerce; Comptroller's Office; Maryland State Library Agency; University System of Maryland; Morgan State University; Baltimore City Community College; Maryland Department of Aging; Maryland Department of Agriculture; Maryland Department of Disabilities; Maryland State Department of Education; Department of General Services; Maryland Department of Health; Department of Housing and Community Development; Department of Juvenile Services; Maryland Department of Labor; Department of Natural Resources; Board of Public Works; Department of State Police; Department of Public Safety and Correctional Services; Military Department; Maryland Department of Transportation; Department of Veterans Affairs; Maryland Insurance Administration; Maryland State Lottery and Gaming Control Agency; Department of Legislative Services

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