

CHAPTER 11: FINANCIAL MANAGEMENT

CHAPTER PURPOSE & CONTENTS

This chapter provides an overview of all of the requirements applicable to the financial management of the CDBG Program. Administrative and planning costs including those costs that are eligible under other categories of eligibility will be covered. CDBG policies and rules regarding pre-award costs, float funded activities, revolving funds, lump sum draw downs and program income will be detailed. Finally, financial management requirements that pertain to accounting systems, allowability of costs, audits, tracking, and use of program income and pre-award costs limitations will be discussed.

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11.1	Administrative and Planning Costs
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11.4	Float Funded Activities
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11.1 Administrative and Planning Costs

Key Topics in This Section: Examples of administrative costs, Examples of planning costs, Charging staff cost under administrative and planning costs

Regulatory/Statutory Citations: Section 105(a)(13), Section 105(a)(12), 570.201(p), 570.205, 570.206, 570.208

Other Reference Materials on This Topic: Guide to National Objectives and Eligible Activities for Entitlement Communities, Chapter 2, CPD Notice 92-19

11.1.1 Eligible Administrative Activities

CDBG funds can be used for administration and planning activities.

Examples of administration activities include:

- General management, oversight and coordination;
- Providing local officials and citizens with information about the CDBG program;
- Preparing budgets and schedules;
- Preparing reports and other HUD-required documents;

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- Monitoring program activities;
- Fair Housing activities;
- Indirect costs; and
- Submission of applications for Federal programs;

With respect to determining the amount of staff costs to charge to program administration, grantees have two options:

Include the entire salary, wages and related costs of each person whose **primary** responsibility involves program administration assignments (e.g., executive director position); or

Determine the *pro rata* share of each person's salary, wages and related costs whose job includes **any** program administration assignments.

Any costs and time charged must be documented through the appropriate means (i.e., invoices, receipts, time and attendance records, etc.). The documentation must be kept on file, and will be reviewed at financial monitoring.

11.1.2 Eligible Planning Activities

Examples of planning activities include:

- Comprehensive plans;
- Community development plans (including the Consolidated Plan);
- Functional plans (for housing; land use and urban environmental design; economic development; open space and recreation; energy use and conservation; floodplain and wetlands management; transportation; utilities; historic preservation; etc.);
- Other plans and studies (e.g., small area and neighborhood plans; capital improvements program plans; individual project plans; general environmental; urban environmental design; historic preservation studies; etc.); and
- Policy planning, management and capacity building activities.

A detailed description of planning and capacity building activities is located at §570.205 of the regulations.

CDBG assistance may also be used to fund activities intended to improve grantee capacity (including subrecipients) to plan and manage programs and activities.

Funds used under this category (by the grantee or subrecipient) are subject to the statutory limitation on planning and administrative cost.

Capacity building is also eligible under the category of Technical Assistance which was discussed previously in this chapter.

Under this category, CDBG funds may not be used for the following activities:

- Engineering, architectural and design costs related to a specific project; or
 - Other costs of implementing plans.
- These costs may be eligible as a part of an eligible project.

11.1.3 National Objectives for Administrative and Planning Activities

CDBG funds expended for administration, planning and capacity building costs are considered to address the national objectives for the CDBG program as a whole; therefore, no documentation of compliance is required.

11.1.4 Costs that are Eligible under Other Categories

The costs of carrying out an activity include not only goods and services provided by third parties, such as construction contractors, but also include the costs incurred by the grantee or subrecipient in connection with the use of its own staff and other resources to carry out the activity. For example, if a grantee's employees underwrite economic development loans that are to be made with CDBG funds, the portion of their salaries spent on this function can be treated as costs of carrying out the activity. This is important because these costs are not subject to the limitation on the use of CDBG funds to pay planning and administrative costs.

Calculating Program Administration and Direct Costs Example

In Smithville's Housing Department, the Rehab Loan Officer is primarily responsible for marketing and outreach of the rehab loan program, application intake and review, and underwriting and preparing of loan packages for approval by a loan committee. These functions are directly related to the rehab loan program and eligible as program delivery costs. However, the Rehab Loan Officer also contributes information for Smithville's Consolidated Plan and annual performance report, and occasionally assists with Fair Housing activities. The Rehab Loan Officer maintains time distribution records documenting the time spent on activity delivery and general program administration. The time distribution records indicate that 80 percent of the Rehab Loan Officer's time is spent on activity delivery and 20 percent is spent on program administration. Consequently, the salary and related costs of the Rehab Loan Officer position will be charged on a pro rata share basis between the rehab loan program (80 percent) and program administration (20 percent).

CDBG funds may be use to pay costs in support of activities that are eligible for HOME program funds. The broad list of services that can be paid for out of CDBG include:

- Housing counseling in connection with tenant-based rental assistance and affordable housing projects,
- Energy auditing,
- Preparation of work specifications,
- Loan processing,
- Inspections,
- Tenant selection,
- Management of tenant-based rental assistance, and
- Other services related to assisting owners, tenants, contractors, and other entities participating or seeking to participate in the HOME program.

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Additionally, 570.206 also provides that CDBG funds may be used to pay for program administration of the HOME program but these administrative costs are counted toward the CDBG administrative cap.

11.2 Planning and Administrative Cap

Key Topics in This Section: Calculating the cap, Determining compliance with the cap

Regulatory/Statutory Citations: 570.200(g), 570.205, 570.206

Other Reference Materials on This Topic: Guide to National Objectives and Eligible Activities for Entitlement Communities, Chapter 2

Planning and administration costs are capped to 20 percent of the sum of grant plus program income that is received during the program year. See chart below on Calculating the Planning and Administrative Costs Cap.

Calculating the Planning and Administrative Costs Cap

Total entitlement grant amount	\$1,000,000
Surplus from Urban Renewal	-
Program income received by grantee and its subrecipients	<u>\$50,000</u>
Total: the basis for calculating the cap	\$1,050,000
<i>Multiplied by 20 percent</i>	<u>x 0.20</u>
Maximum dollar level that may obligated and charged to Planning and Capacity Building and Program Administration	\$210,000

* NOTE: This example is for illustrative purposes only.

With respect to compliance, grantees will be considered to be in compliance if total obligations charged under planning and administration during the most recently completed program year are no greater than 20 percent of the sum of the entitlement grant for the program year, and the program income received during that program year by grantee and its subrecipient.

See chart below on Determining Compliance with the Planning and Administrative Costs Cap for specific steps in determining compliance.

Determining Compliance with the Planning and Administrative Costs Cap

Total costs under Planning and Administration for the program year	\$150,000
Add unliquidated obligations for planning and administration activities, as of the end of the program year	\$35,000
Subtract unliquidated obligations for planning and administration activities, as of the end of the preceding program year	<u>(\$20,000)</u>
Net obligations for planning and administration during the program year	\$165,000
Compare to maximum dollar level calculated above to determine planning and administrative cost cap	\$210,000

* NOTE: This example is for illustrative purposes only.

11.3 Pre-Award Costs

Key Topics in This Section: Requirements, Waivers

Regulatory/Statutory Citations: 570.200(h)

Other Reference Materials on This Topic

Under certain conditions, CDBG grantees and their subrecipients may incur costs prior to the effective date of their CDBG grant agreement with HUD. The grantee or subrecipient may then pay those costs (including reimbursing itself if it used its own funds to pay the costs) after the effective date of the grant agreement, provided that it complies with the pre-award regulations at 24 CFR §570.200(h).

The effective date of the grant agreement is the program year start date, or the date that the consolidated plan is received by HUD, whichever is later.

The CDBG regulations were revised in 1995 to offer more flexibility to grantees in incurring pre-award costs. Previously, the regulations limited the types of costs that could be incurred. Since the change in 1995, grantees can incur any eligible cost provided it meets certain conditions:

The activity for which the costs are being incurred is included in a consolidated plan action plan, an amended consolidated plan action plan, or a Section 108 loan guarantee application **prior** to the costs being incurred;

Citizens are advised of the extent to which these pre-award costs will affect future grants;

The costs and activities funded are in compliance with the CDBG regulations and the environmental review requirements;

The activity for which payment is being made complies with the statutory and regulatory provisions in effect at the time the costs are paid for with CDBG funds;

CDBG payment will be made during a time no longer than the next two program years following the effective date of the grant agreement or amendment in which the activity is first included; and

The total amount of pre-award costs to be paid during any program year is no more than 25 percent of grant amount for that year or \$300,000, whichever is greater.

Upon the written request of the grantee, the HUD field office may authorize payment of pre-award costs for activities that do not meet the above requirement for a two-year payback or where the total amount exceeds 25 percent of the grant amount. (NOTE: An exception to any of the other criteria requires a waiver.)

The factors HUD will consider in granting exceptions to the period of repayment or the dollar threshold include:

Whether granting the authority would result in a significant contribution to the goals and purposes of the CDBG program;

Whether failure to grant the authority would result in undue hardship to the grantee or beneficiaries of the activity;

Whether granting the authority would not result in a violation of a statutory provision or any other regulatory provisions;

Whether circumstances are clearly beyond the grantees control; and

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Any other relevant considerations.

The HUD review begins at the Field Office level, but when a waiver is necessary, it is referred to the Assistant Secretary's office.

An example of the flexibility that this provision offers to grantees: a grantee constructs a large public improvement using a mix of current year CDBG funding and proceeds from a local bond issuance. The grantee uses a portion of its CDBG funding from the subsequent program year to pay off the local indebtedness without requesting the prior approval of HUD (provided the construction meets the applicable requirements and the amount of the pre-award costs does not exceed the above limitation).

11.4 Float-Funded Activities

Key Topics in This Section: Description of purpose, Requirements

Regulatory/Statutory Citations: 570.301

Other Reference Materials on This Topic: Guide to National Objectives and Eligible Activities for Entitlement Communities, Appendix A: making the Most of Your CDBG Resources

CDBG grantees have a line of credit that covers the amount of CDBG funds that are available for the grantee to expend. The grantee's Consolidated Plan establishes how these funds will be used.

Sometimes, however, activities take longer to get started than initially anticipated and funds for undertaking these planned activities remain in the grantee's line of credit. Under this circumstance, HUD permits grantees to use a financing technique called float funding.

Under the float funding provision (at 570.301), the grantee uses the amount of funds available in the line of credit to fund an alternate eligible activity with the assumption that these funds will be repaid by the alternate activity and then used to fund the originally planned activity.

For example, assume that a grantee plans to use \$500,000 of CDBG funds to build a new community center. However, it will take two years to conduct the environmental review, have an architect design the building, and finally initiate the construction. So, much of that \$500,000 is just sitting in the grantee's line of credit. Meanwhile, the grantee receives an application from a developer for a housing project which needs \$300,000 in financing. The financing will be provided under a short term rehabilitation loan that will be taken out with the proceeds from the equity syndication of low income housing tax credits over the next year. However, the grantee has already allocated all of its available CDBG funds to various eligible projects. So, it makes a CDBG float loan to the developer, using \$300,000 of the \$500,000 planned for the community center. When the equity from syndication of the tax credits is received, the float loan is repaid. The program income derived from the repayment is then available to finance the community center.

All float-funded activities must meet all of the same requirements that apply to all other CDBG activities. In addition, the following requirements must be met:

Float funded activities should generate sufficient program income to permit the originally planned activity to be carried out.

This program income must be received within 2.5 years from the time of obligation for the float-funded activity.

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Extensions to this repayment period are considered new float-funded activities.

The float-funded activity must be included in the Action Plan for the year or the Action Plan must be amended.

The **full amount** of the projected program income from the float-funded activity must be shown as a source of program income in the Action Plan covering the activity, regardless of whether the income is expected in a future program year.

The Action Plan must also clearly describe:

How it will eliminate/amend activities should the float-funded project fail to produce the needed program income; or

The grantee's commitment to obtain an irrevocable line of credit from a commercial lender for the full amount of the float-funded activity; or

How the grantee will transfer general local funds to the CDBG line of credit within 30 days to cover any default or shortfall; or

Any other method that the grantee will use to secure timely return of the amount of float funding. HUD must approve these other methods in writing.

11.5 Revolving Funds

Key Topics in This Section: Description of purpose, Requirements

Regulatory/Statutory Citations: 24 CFR Subpart J –Grant Administration

Other Reference Materials on This Topic

Revolving loan funds are specifically allowed within the CDBG program. Many CDBG grantees use revolving funds in conjunction with single family rehabilitation programs (as well as for other activities such as microenterprise loans).

A revolving fund is a separate fund (independent of other CDBG program accounts) set up for the purpose of carrying out specific activities. These activities generate payments to the account for use in carrying out the same types of activities.

Program income that is held in a revolving fund does not have to be used before grant funds are drawn down for a different type of CDBG project. However, program income in a revolving fund must be used before additional grant funds are drawn down for revolving fund activities.

Requirements of CDBG-funded revolving funds include:

Revolving funds must be held in interest bearing accounts; and

Interest earned on revolving fund balances must be remitted to the U.S. Treasury not less than annually. (NOTE: Interest paid by borrowers of CDBG-funded loans made from the revolving fund is considered program income and subject to the CDBG program income requirements.)

11.6 Lump Sum Draw Downs

Key Topics in This Section: Description of lump sum draw down purpose, Requirements

Regulatory/Statutory Citations: 570.513

Other Reference Materials on This Topic

Grantees may draw down funds from HUD in a lump sum to establish a rehabilitation fund in one or more private financial institutions for the purpose of financing eligible rehab activities. The reason grantees may want to establish such a fund is to receive benefits (described below) from the lending institution with which it places the lump sum.

The regulations governing lump sum draw downs, which are located at 570.513, stipulate that:

The fund may be used in conjunction with various rehabilitation financing techniques, including loans, interest subsidies, loan guaranties, loan reserves, or other uses approved by HUD.

The fund may not be used for making grants, except when grants are made to leverage non-CDBG funds.

Lump sum draw downs are subject to the following limitations:

Deposits to a rehabilitation fund can not exceed the grant amount that the grantee reasonably expects will be required based on either the prior level of rehabilitation activity or rehabilitation staffing and management capacity during the period specified in the agreement to undertake activities;

No grant funds may be deposited under this section solely for the purpose of investment, notwithstanding that the interest or other income is to be used for the rehabilitation activities; and

Rehab program administrative costs and the administrative costs of the financial institution may not be funded through lump sum draw down.

The following standards apply to all lump sum draw downs of CDBG funds for rehabilitation:

Grantees must execute a written agreement with one or more private financial institutions for the operation of the rehabilitation fund.

The agreement must specify:

The obligations and responsibilities of the parties;

The terms and conditions on which CDBG funds are to be deposited and used or returned;

The anticipated level of rehabilitation activities by the financial institution;

The rate of interest and other benefits to be provided by the financial institution, in return for the lump sum deposit;

The agreement must provide that the rehabilitation fund may only be used for authorized activities during a period of no more than two years; and

Such other terms as are necessary for compliance with the provisions of this section.

The lump sum deposit shall be made only after the agreement is fully executed.

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Upon execution of the agreement, a copy must be provided to the HUD field office for its record and use in monitoring. Modifications made during the term of the agreement must also be provided to HUD.

The CDBG regulations include time limits on the use of funds deposited:

The use of funds for rehabilitation financing assistance must start (i.e., the first loan must be made, subsidized or guaranteed) within 45 days of the deposit; and

Substantial disbursements from the fund must occur within 180 days of the receipt of the deposit.

Deposited funds or program income derived from deposited funds may be used to subsidize or guarantee repayments of rehab loans made with non-CDBG funds *but* the rehabilitation activity would be considered to be CDBG-assisted and subject to the requirements applicable to the type of activity undertaken. (NOTE: The repayment of the non-CDBG funds is not considered program income.)

The private financial institution receiving the lump sum deposits must provide specific consideration to the grantee in exchange for such deposits. The minimum requirements for such benefits are as follows:

Grantees shall require the financial institution to pay interest on the lump sum deposit;

The interest rate paid by the financial institution shall be no more than three points below the rate on one year Treasury obligations at constant maturity;

When an agreement sets a fixed interest rate for the entire term of the agreement, the rate should be based on the rate at the time the agreement is executed;

The agreement may provide for an interest rate that would fluctuate periodically during the term of the agreement, but at no time shall the rate be established at more than three points below the rate on one year Treasury obligations at constant maturity;

In addition to the payment of interest, at least one of the following benefits must be provided by the financial institution:

Leverage of the deposited funds so that the financial institution commits private funds for loans in the rehabilitation program in an amount substantially in excess of the amount of the lump sum deposit;

Commitment of private funds by the financial institution for rehabilitation loans at below market interest rates, at higher than normal risk, or with longer than normal repayment periods; or

Provision of administrative services in support of the rehabilitation program by the participating financial institution at no cost or at lower than actual cost.

Interest earned on lump sum deposits and payments on loans made from such deposits is considered program income. During the period of the agreement, program income must be used for rehabilitation activities in accordance with the requirements covering the rehabilitation fund.

Grantees must provide the HUD field office with written notification of the amount of funds to be distributed to a private financial institution before the distribution occurs.

11.7 Timely Expenditure of Funds

A very important concept in administering CDBG activities is planning for the timely expenditure of funds. This section highlights those rules.

Key Topics in This Section: Timely expenditure of CDBG funds

Regulatory/Statutory Citations: 570.902

Other Reference Materials on This Topic: Ensuring CDBG Subrecipient Timeliness - Guidelines for Grantee Selection, Management, and Oversight in the Community Development Block Grant Program

<http://www.hud.gov/offices/cpd/communitydevelopment/library/timeliness.pdf>, Keeping CDBG Funds Moving Guidelines for managing your overall Community Development Block Grant Program in a timely manner,
<http://www.hud.gov/offices/cpd/communitydevelopment/library/keepfundsmoving.pdf>, Methods for Improving Timely Performance for the State Community Development Block Grant Program,
<http://www.hud.gov/offices/cpd/communitydevelopment/library/statetimeliness.pdf>

Timeliness refers to how quickly the grantee is able to commit and expend CDBG funds. Since federal program budgets are tight all across the government and since there is a huge need for community development programs, it is vital that CDBG grantees make every effort to quickly use their funds.

The entitlement program rule for timeliness is that that grantee cannot have more than 1.5 times their annual allocation sitting in their line of credit at the U.S. Treasury.

So, if the grantee has a \$2 million dollar CDBG allocation, they may not have any more than \$3 million in their CDBG account in IDIS.

This analysis for entitlements is calculated at 60 days prior to the end of the grantee's program year.

If the grantee chronically has more than 1.5 times their allocation in their line of credit, HUD can withhold future grants until the grantee effectively spends their existing resources.

11.8 Program Income

Key Topics in This Section: Definition, Remission

Regulatory/Statutory Citations: 570.504

Other Reference Materials on This Topic

Program Income Defined: Program income is the gross income received by the grantee and its subrecipients directly generated from the use of CDBG funds.

Program income includes:

Proceeds from the sale or lease of property purchased or improved with CDBG funds;

Proceeds from the sale or lease of equipment purchased with CDBG funds;

Gross income from the use or rental of real or personal property acquired, constructed or improved by the grantee (or a subrecipient), less costs incidental to the generation of income;

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Payments of principal and interest on loans made using CDBG funds;

Proceeds from the sale of loans or obligations secured by loans made with CDBG funds;

Interest earned on program income pending its disposition (NOTE: interest earned on CDBG funds held in revolving loan funds is not program income and must be remitted to the U.S. Treasury at least annually); and

Funds collected through special assessments on properties not owned and occupied by LMI households in order to recover the CDBG portion of a public improvement.

Program income does not include:

Income earned from the investment of initial proceeds of a grant advance from the U.S. Treasury; interest earned on loans or other forms of assistance with CDBG funds that are used for activities that are determined by HUD to be ineligible; interest earned on reimbursements to the program account prior to the use of the reimbursed funds for eligible activities;

Any income received in a single program year by the grantee *and* its subrecipients, that does not exceed \$25,000;

Income generated by certain Section 108 activities (refer to 570.500(a)(4)(ii));

Proceeds from subrecipient fundraising activities;

Funds collected through special assessments to recover non-CDBG outlays of capital improvements; and

Proceeds from the disposition of real property by a subrecipient that was acquired or improved with CDBG funds five years after the termination of the subrecipient agreement. (Certain conditions apply. Refer to 570.503(b)(7).)

The calculation of the amount of program income for the grantee's CDBG program as a whole (comprising activities carried out by the grantee and its subrecipients) shall exclude payments made by subrecipients of principal and/or interest on CDBG-funded loans received from grantees if such payments are made using program income received by the subrecipient.

Remittance of Program Income: The CDBG regulations require that, at the end of each program year, grantees must determine whether they have excess program income on hand and return any excess to its line of credit. Excess program income is calculated by:

1. Assessing the aggregate amount of program income held by the grantee *and* its subrecipients.
2. Subtracting the following from the aggregate amount:
 - Any funds needed for immediate cash needs (i.e., needed within the next 30 days to pay outstanding bills);
 - Revolving loan fund balances;
 - Lump sum draw down balances; and
 - Cash or investments held as security for Section 108 loan guarantees.

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3. Any amount remaining after the deductions that is in excess of one-twelfth of the grantee's most recent entitlement grant must be remitted to the grantee's line of credit as soon as practicable after the excess amount is determined.

Sample Calculation for Remittance of Program Income

Amount of program income held by grantee and subrecipients:	\$380,000
Less:	
Immediate cash needs (bills to be paid within 30 days)	(\$20,000)
Revolving loan fund balance:	(\$180,000)
Lump sum draw down:	(\$0)
Cash held as Section 108 security:	(\$0)
Balance:	<u>\$180,000</u>
Annual CDBG entitlement:	\$2,400,000
1/12 annual entitlement:	\$200,000
Amount to be remitted to line of credit:	\$0
No funds to be remitted because program income balance does not exceed 1/12 of annual entitlement.	

11.9 Uniform Administrative Requirements

Key Topics in This Section: Cost Principles, Cost reasonableness, Cost allowability, Cost allocation, Indirect costs, Standards for Financial Management Systems, Internal controls, Budget controls, Accounting controls, Cash management, Audits, Type/level of audit required, Scope of audits, Auditor selection/procurement, Audit costs, Audit review and resolution

Regulatory/Statutory Citations: 570.502, 84, 85

Other Reference Materials on This Topic: OMB Circular A-87, OMB Circular A-133

The CDBG regulations require that grantees and subrecipients that are governmental entities or public agencies adhere to certain administrative requirements. These requirements include:

OMB Circular A-87 “Cost Principles for State, Local and Indian Tribal Governments”— This circular establishes principles and standards for determining allowable costs under Federal grants.

Specific provisions of 24 CFR Part 85 (see 570.502(a))—These regulations set forth uniform requirements for financial management systems, reports, and records and grant close-outs for grantees of Federal grant funding.

Non-profit subrecipients are required to comply with the following uniform administrative requirements:

OMB Circular A-122 “Cost Principles for Non-Profit Organizations” or, for institutions of higher education, OMB Circular A-21 “Cost Principles for Educational Institutions”—This circular establishes principles for determining allowable costs under grants, contracts and other agreements with nonprofit organizations.

Specific provisions of 24 CFR Part 84 (see 570.502(b))—These regulations set forth uniform requirements for nonprofit organizations, including financial management systems, property standards, procurement standards, reporting, and record keeping. NOTE: 24 CFR Part 84 implements OMB Circular A-110.

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In addition, local governments *and* nonprofit organizations are required to comply with **OMB Circular A-133 “Audits of Institutions of States, Local Governments and Nonprofit Institutions”**.

11.9.1 Cost Principles

Cost Allowability

OMB Circulars A-87 (state and local governments) and A-122 (nonprofits) provide basic guidelines for determining whether a cost is allowable.

To be allowable under CDBG (and other federal programs), cost must meet the following general criteria:

- Be necessary and reasonable for proper and efficient performance and administration of the federal award;

- Be allocable to the federal award under the provisions of the OMB circulars (see below);

- Be authorized or not prohibited under state or local laws or regulations;

- Conform to any limitations or exclusions set forth in the OMB circulars, federal laws, terms and conditions of the federal award, or other governing regulations as to types or amounts of cost items;

- Be consistent with policies, regulations and procedures that apply uniformly to both federal awards and other activities of the governmental unit;

- Be accorded consistent treatment; a cost may not be assigned to the CDBG program as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the program as an indirect cost;

- Be determined in accordance with generally accepted accounting principles;

- Not be included as a cost or used to meet cost sharing or matching requirements of any other federal award in either the current or a prior period, except as specifically provided by federal law or regulation;

- Be the net of applicable credits (that is, any credits such as discounts or price adjustments must be deducted from the total costs charged); and

- Be adequately documented.

The OMB circulars also contain a “selected” list of costs that are allowable or unallowable. However, the fact that an item of cost is not included does not mean it’s unallowable. Rather the cost’s allowability is determined by reference to the basic guidelines.

Cost Allocation

As mentioned previously, costs charged to CDBG must also be allocable to the CDBG program. A cost is allocable if it:

- Is treated consistently with other costs incurred for the same purpose in like circumstances (i.e., grantees/subrecipients must treat costs consistently for all grant programs); and

- Is incurred specifically for the CDBG program;

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Benefits both the CDBG program and other work and can be distributed in reasonable proportion to the benefits received; or

Is necessary to the overall operation of the organization, although a direct relationship to any particular cost objective cannot be shown.

Any costs allocable to a particular federal award or cost objective (such as CDBG) may not be charged to other federal awards to overcome funding deficiencies, to avoid restrictions imposed by law or the terms of the federal award, or for other reasons.

Indirect Costs - OMB Circular A-87 (State and Local Governments)

OMB Circular A-87 requires that governmental entities support indirect costs with a cost allocation plan or an indirect cost proposal prepared in accordance with the circular. Indirect costs should be allocated in a manner which will result in the grant program bearing its fair share of total indirect costs.

A **central service cost allocation plan** is required if the local government has indirect costs resulting from centralized services that will be charged to federal awards.

A central service cost allocation plan, for the purposes of local governments, refers to a description of a process whereby services provided on a centralized basis (e.g., motor pools, computer centers, purchasing and accounting services) can be identified and assigned to benefited departments/agencies (e.g., the department/agency administering the CDBG program) on a reasonable and consistent basis.

Refer to Attachment C of OMB Circular A-87 for additional information.

An **indirect cost proposal** is required if the local government has indirect costs resulting from centralized services that will be charged to federal awards and other indirect costs originating in various departments/agencies carrying out federal awards.

An indirect cost proposal is the documentation prepared by a governmental entity to substantiate its request for the establishment of an indirect cost rate. This rate, expressed in percentage terms, is applied to direct costs in order to determine the amount of reimbursement a grantee can obtain for indirect costs.

For instructions on preparing indirect cost proposals, refer to Attachment E of OMB Circular A-87.

Indirect Costs - OMB Circular A-122 (Nonprofits)

Under OMB Circular A-122, there are three methods nonprofits are required to utilize for allocating indirect costs. Each method is applicable to certain specific circumstances.

Simplified allocation method:

Used when a nonprofit organization has only one major function, or where all its major functions benefit from its indirect costs to approximately the same degree.

The indirect cost rate is calculated by separating the organization's total costs for the base period (e.g., fiscal year) as either direct or indirect, and dividing the total allowable indirect costs by an equitable distribution base (total direct costs, direct salaries or other equitable distribution base).

Multiple allocation base method:

Used when major functions benefit in varying degrees from indirect costs.

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Costs are separated into distinct groupings, and each grouping is then allocated to benefiting functions by means of a base which best measures relative benefits. An indirect cost rate must be developed for each grouping.

Direct allocation method:

This method may be used for those nonprofits that treat all costs as direct costs *except* general administration and general expenses.

These joint costs are prorated individually as direct costs to cost objectives using a base most appropriate to the particular cost being prorated. The base must be established in accordance with reasonable criteria and must be supported by current data.

Indirect cost rates determined through one of the three prescribed methods must be submitted to and approved by the federal agency that provides the largest dollar value of funds to the nonprofit.

A written agreement is executed between the nonprofit and the approving federal agency signifying the approval of the proposed indirect cost rate.

11.9.2 Standards for Financial Management Systems

In accordance with 24 CFR parts 85 and 84, grantees and subrecipients of CDBG funds must have financial management systems in place that comply with the following standards:

Provide effective control over and accountability for all funds, property and other assets;

Identify the source and application of funds for federally-sponsored activities, including records and reports that:

Verify the “reasonableness, allowability and allocability” of costs; and

Verify that funds have not been used in violation of any of the restrictions or prohibitions that apply to the federal assistance (through the use of budget controls and adequate accounting records).

Permit the accurate, complete and timely disclosure of financial results in accordance with HUD reporting requirements or, for subrecipients, grantee reporting requirements.

Minimize the time elapsing between the transfer of funds from the U.S. Treasury and disbursement by the grantee or subrecipient.

Internal Controls

Internal controls are the combination of policies, procedures, job responsibilities, personnel and records that together create accountability in an organization’s financial system and safeguard its cash, property and other assets.

Through its system of internal controls, an organization can ensure that:

Resources are used for authorized purposes and in a manner consistent with applicable laws, regulations and policies;

Resources are protected against waste, mismanagement or loss; and

Information on the source, amount and use of funds are reliable, secured and up-to-date and that this information is disclosed in the appropriate reports and records.

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The basic elements of an internal control system include:

An organizational chart setting forth the actual lines of responsibility of personnel involved in financial transactions.

Written definition and delineation of duties among key personnel involved in financial transactions.

An accounting policy and procedures manual that includes:

Specific approval authority for financial transactions and guidelines for controlling expenditures;

A set of written procedures for recording of transactions; and

A chart of accounts.

Adequate separation of duties so that no one individual has authority over a financial transaction from beginning to end. In other words, one person should not have responsibility for *more than one* of the following functions:

Authorization to execute a transaction.

Recording of the transaction.

Custody of the assets involved in the transaction.

Hiring policies ensuring that staff qualifications are commensurate with job responsibilities.

Control over assets, blank forms and confidential documents so that these types of documents are limited to authorized personnel only.

Periodic comparisons of financial records to actual assets and liabilities (i.e., reconciliation). In cases where discrepancies are found, corrective action must be taken to resolve such discrepancies.

Budget Controls

Recipients and subrecipients of CDBG funds must have procedures in place to compare and control expenditures against approved budgets for CDBG-funded activities.

A grantee or subrecipient must:

Maintain in its accounting records (see below) the amounts budgeted for eligible activities;

Periodically compare actual obligations and expenditures to date against planned obligations and expenditures, and against projected accomplishments for such outlays; and

Report deviations from budget and program plans, and request approval for budget and program plan revisions.

Accounting Records

Recipients and subrecipients of CDBG funds are required to have accounting records that sufficiently identify the source and application of CDBG funds provided to them.

To meet this requirement, an organization's accounting system should include at least the following elements:

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Chart of accounts - This is a list of account names and the numbers assigned to each of the account names. The names provide a description of the type of transactions that will be recorded in each account (e.g., an account titled “cash” denotes that only transactions affecting cash should be recorded in that account). The account number is required by most accounting software programs and is assigned to an account name to group similar types of accounts. For example, all asset accounts will begin with a “#1” and all liability accounts will begin with a “#2”. A typical chart of accounts will generally include the following categories: assets, liabilities, net assets/fund balance, revenues and expenses.

Cash receipts journal - A cash receipts journal documents, in chronological order, when funds were received, in what amounts and from what sources.

Cash disbursements journal - A cash disbursements journal documents, in chronological order, when an expense was incurred, for what purpose, how much was paid and to whom it was paid.

Payroll journal - A payroll journal documents payroll and payroll related benefit expenses on salaries and benefits, including distinguishing between categories for regulatory purposes.

General ledger - A general ledger summarizes, in chronological order, the activity and financial status of all the accounts of an organization. Information is transferred to the general ledger after it is entered into the appropriate journal. Entries transferred to the general ledger should be cross-referenced to the applicable journal to permit the tracing of any financial transaction.

All journal entries must be properly approved and supported by source documentation. Documentation must show that costs charged against CDBG were:

Incurred during the effective period of the agreement with HUD or, for subrecipients, with the grantee;

Actually paid out (or properly accrued);

Expended on eligible items; and

Approved by the appropriate official(s) within the organization.

Source documentation must explain the basis of the costs incurred and the actual dates of the expenditure. For example:

Source documentation for payroll would include employment letters, authorizations for rates of pay and benefits and time and attendance records.

Source documentation on supplies would include purchase orders or purchase requisition forms, invoices from vendors, canceled checks made to vendors, information on where the supplies are stored and the purpose for which they are being used.

Recipients and subrecipients of CDBG funds must ensure that their accounting records include reliable, up-to-date information on the sources and uses of CDBG funds, including:

Amount of federal funds received;

Current authorization of funds;

Obligations of funds;

Unobligated balances;

Assets and liabilities;

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Program income; and

Actual expenditures broken down by the grant program and year for which the funds are derived and the activity on which the funds were used.

Cash Management

Recipients and subrecipients are required to have procedures in place to minimize the amount of time that elapses between receipt of CDBG funds and the actual disbursement of those funds.

This requirement is intended to curtail unnecessary drawdowns of CDBG funds and minimize the cost of financing the CDBG program by the federal government.

There are three general methods available to transfer CDBG funds from the U.S. Treasury to grantees (or from the grantee to a subrecipient):

Reimbursement method - The reimbursement method entails a transfer of grant funds to the grantee (or subrecipient) based on actual expenditures of the grantee prior to the receipt of CDBG funds. This method would only be used for CDBG grantees when HUD has imposed such payment method as a remedy for failure to comply with applicable requirements.

Cash advance method - The cash advance method involves the transfer of CDBG funds to the grantee (or subrecipient) to meet obligations before actual cash disbursements have been made. This is the method used to fund most CDBG grantees.

Working capital method - The subrecipient is advanced cash to meet its estimated disbursements for an initial period. After the initial period, the subrecipient will receive cash on a reimbursement basis. This method is used when the subrecipient lacks sufficient working capital. Note, however, that this method cannot be used if the reason for using it is the unwillingness or inability of the grantee to provide timely advances to the subrecipient to meet the subrecipient's actual cash disbursement.

Requirements concerning cash management include the following:

Recipients (and subrecipients) must include accurate information in drawdown requests.

Funds drawn down erroneously must be returned. (This includes funds drawn down under the cash advance method where the expenditure of funds is delayed.)

Disbursement of funds must occur in a timely manner. While there is no explicit time period, the general rule is that payment must take place within three business days of deposit of CDBG funds. If payment takes longer than three business days, written justification should be maintained in the files.

If grant advances are placed in an interest-bearing account, interest income must be remitted to the U.S. Treasury. (However, interest amounts up to \$100 per year may be retained by the grantee for administrative expenses.)

Program income (other than program income deposited in a revolving fund) must be disbursed prior to the draw down of additional funds from the Treasury (or, in the case of subrecipients, from the grantee).

Program income in a revolving fund must be disbursed for the activity for which the fund was established before additional requests are made for new CDBG funds.

11.9.3 Audit Requirements

Type/Level of Audit Required

States, local government and nonprofit organizations are required to comply with **OMB Circular A-133** "Audits of States, Local Governments and Non-profit Organizations".

The type/level of audit required by the OMB circulars is based on the amount of federal financial assistance expended by an organization in any given year.

CDBG grantees and subrecipients that expend \$500,000 or more in a year in Federal awards must have an audit conducted in accordance with **OMB Circular A-133** except when they elect to have a program-specific audit conducted

A **program audit** is an audit of one federal program (such as CDBG). A program-specific audit is allowed when the grantee or subrecipient expends federal awards under only one federal program.

A **single audit** is an audit that includes both an entity's financial statements and its federal awards (from all applicable federal programs).

If a grantee or subrecipient expends less than \$500,000 a year in federal awards, it is exempt from the audit requirements for that year; however, records must be available for review or audit by appropriate officials of the federal agency, pass-through entity and the Government Accountability Office.

Scope of Audits

Audits performed for grantees and subrecipients of federal funds must be performed by an independent auditor in accordance with Government Auditing Standards and must be conducted in accordance with the OMB circulars.

Specifically, the audit will cover three areas:

Financial statements'

Internal control; and

Compliance with applicable laws and regulations.

Audit Reports

Following the completion of the audit, an audit report must be prepared. The audit report must contain at least the following:

An opinion (or disclaimer of opinion) as to whether the financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles and an opinion (or disclaimer of opinion) as to whether the schedule of expenditures of Federal awards is presented fairly in all material respects in relation to the financial statements taken as a whole;

A report on internal control related to the financial statements and major programs. This report shall describe the scope of testing of internal control and the results of the tests, and, where applicable, refer to the separate schedule of findings and questioned costs;

A report on compliance with laws, regulations, and the provisions of contracts or grant agreements, noncompliance with which could have a material effect on the financial

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statements. This report shall also include an opinion (or disclaimer of opinion) as to whether the grantee or subrecipient complied with laws, regulations, and the provisions of contracts or grant agreements which could have a direct and material effect on each major program, and, where applicable, refer to the separate schedule of findings and questioned costs; and

A schedule of findings and questioned costs that includes a summary of the auditor's results, findings relating to the financial statements which are required to be reported in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States, and findings and questioned costs for Federal awards.

The audit must be completed and report submitted to the Federal clearinghouse designated by OMB within the earlier of 30 days after receipt of the auditor's report(s), or 13 months after the end of the audit period. The grantee or subrecipient shall make copies available for public inspection.

Copies of audit reports must be kept on file for a minimum of three years from the date of submission to the Federal clearinghouse designated by OMB.

The auditor shall retain working papers and reports for a minimum of three years after the date of issuance of the auditor's report(s) to the grantee or subrecipient, unless the auditor is notified in writing by the cognizant agency for audit, oversight agency for audit, or pass-through entity to extend the retention period.

If there are unresolved audit issues at the end of this three-year period, the grantee or subrecipient should notify the auditor in writing to extend the retention period.

Auditor Selection/Procurement

In arranging for audit services, grantees and subrecipients must follow the procurement standards found in 24 CFR Part 85 or 84, as applicable.

Whenever possible, grantees and subrecipients shall make positive efforts to utilize small businesses, minority-owned firms, and women's business enterprises, in procuring audit services. In requesting proposals for audit services, the objectives and scope of the audit should be made clear. Factors to be considered in evaluating each proposal for audit services include the responsiveness to the request for proposal, relevant experience, availability of staff with professional qualifications and technical abilities, the results of external quality control reviews, and price

Audit Costs

The costs of audits made in accordance with the applicable regulations are allowable charges to federal assistance programs.

These charges can be treated as either a direct cost or an allocated indirect cost, as determined in accordance with the provisions of applicable OMB cost principles circulars.

The cost of any audit under OMB Circular A-133 not conducted in accordance with this part is unallowable. The cost of auditing a non-Federal entity which has Federal awards expended of less than \$500,000 per year and is thereby exempted from having an audit conducted under this part is also not allowable. However, this does not prohibit a CDBG grantee from charging Federal awards for the cost of limited scope audits to monitor its subrecipients, provided the subrecipient does not have a single audit. For purposes of this part, limited scope audits only include agreed-upon procedures engagements conducted in accordance with either the

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AICPA's generally accepted auditing standards or attestation standards, that are paid for and arranged by the CDBG grantee and address only one or more of the following types of compliance requirements: activities allowed or unallowed; allowable costs/cost principles; eligibility; matching, level of effort, earmarking; and, reporting.

Pass-through Responsibilities

The CDBG grantee, as a “pass-through entity” under OMB Circular A-133, must perform the following actions with respect to its subrecipients:

Identify Federal awards made by informing each subrecipient of CFDA title and number, award name and number, award year, and name of Federal agency. When some of this information is not available, grantee shall provide the best information available to describe the Federal award.

Advise subrecipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements as well as any supplemental requirements imposed by the grantee.

Monitor the activities of subrecipients as necessary to ensure that CDBG funds are used for authorized purposes in compliance with laws, regulations, and the provisions of the subrecipient agreement and that performance goals are achieved.

Ensure that a subrecipient expending \$500,000 or more in Federal awards during the subrecipient's fiscal year has met the audit requirements of OMB Circular A-133 for that fiscal year.

Issue a management decision on audit findings within six months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action.

Consider whether subrecipient audits necessitate adjustment of the pass-through entity's own records.

Require each subrecipient to permit the pass-through entity and auditors to have access to the records and financial statements as necessary for the pass-through entity to comply with this part.

11.10 Change of Use

Key Topics in This Section: Change of use requirements

Regulatory/Statutory Citations: 570.503, 570.505

Other Reference Materials on This Topic

The standards described in this section apply to real property within the grantee's control (including activities undertaken by subrecipients) that was acquired or improved, in whole or in part, using CDBG funds in excess of \$25,000. These standards shall apply from the date CDBG funds are first spent for the property until five years after final close-out of the grant from which assistance to the property was provided.

A grantee may not change the use or planned use of any such property (including the beneficiaries of such use) from that for which the acquisition or improvement was made, unless

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the grantee provides affected citizens with reasonable notice of and opportunity to comment on any proposed change, and either:

The new use of the property qualifies as meeting one of the national objectives and is not a building for the general conduct of government; or

The grantee determines, after consultation with affected citizens, that it is appropriate to change the use of the property to a use which does not qualify as meeting a National Objective, it may retain or dispose of the property for the changed use if the grantee's CDBG program is reimbursed in the amount of the current fair market value of the property, less any portion of the value attributable to expenditures of non-CDBG funds for acquisition of, and improvements to, the property.

Following the reimbursement of the CDBG program, the property no longer will be subject to any CDBG requirements.