

# CHAPTER 16: 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 loan funds, state 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.

SECTION	TOPIC
16.1	Administrative, Planning and TA Costs
16.2	Planning, Administration and TA Cap
16.3	Pre-Award Costs
16.4	Float Funded Activities
16.5	Revolving Loan Funds (RLF)
16.6	State Revolving Funds (SRF)
16.7	Lump Sum Draw Downs
16.8	Timely Distribution of Funds
16.9	Program Income
16.10	Uniform Administration Requirements
16.11	Procurement and Conflict of Interest
16.12	Change of Use

## 16.1 Administrative, Planning and Technical Assistance Costs

Key Topics in This Section	<ul style="list-style-type: none"> <li>✓ Eligible administrative activities</li> <li>✓ Eligible planning activities</li> <li>✓ Project delivery costs</li> </ul>
Statutory Citations	Section 105(a)(13), Section 105(a)(12)
Other Reference Materials on This Topic	<ul style="list-style-type: none"> <li>✓ Guide to National Objectives and Eligible Activities for States                             <ul style="list-style-type: none"> <li>- Chapter 2</li> </ul> </li> <li>✓ CPD Notice 92-19</li> </ul>



### **16.1.1 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;
      - 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, states 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.

### **16.1.2 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.
- ✓ CDBG assistance may also be used to fund activities intended to improve state capacity (including UGLG) to plan and manage programs and activities.
- ✓ Funds used under this category 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 manual.
- ✓ 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.

### **16.1.3 Technical Assistance**

- ✓ The TA set-aside was made available to states in 1992 by its inclusion in Section 811 of Housing and Community Development Act of 1992. The set-aside is codified at Section 106(d)(5) of the Housing and Community Development Act of 1974 as amended (the Act).
- ✓ In the 2004 Consolidated Appropriations Act, Congress amended Section 106(d) of the Housing and Community Development Act of 1974 (HCDA) to allow grantees to spend a larger percentage of CDBG dollars on either administrative/planning costs or TA, provided that the total amount spent between the two categories does not exceed 3 percent of the current year's allocation + program income + reallocated funds. This change also moved the TA provision to be in the same paragraph as the 2% State Administration costs.
- ✓ States are still responsible for matching CDBG admin expenses dollar for dollar after the first \$100,000. However, TA costs do not need to be matched.
- ✓ Currently, states cannot use program income in calculating the amount of CDBG funds that they can spend on TA in a given year, as they can when calculating administrative costs. HUD is giving strong consideration to allowing states to calculate program income into the amount of CDBG funds they are permitted to spend on TA. HUD would be required to change the regulations to do so, however.
- ✓ Technical assistance funds can be used to:
  - Pay for state staff to provide TA;
  - Hire contractor to provide TA;
  - Grant funds to recipients to allow them to purchase TA;
  - Grant funds to subrecipient such as regional planning organization or Community college to provide TA;
  - Pay for tuition, training and or travel for trainees from UGLG's and non-profits or
  - Transfer funds to another state agency for the provision of TA.
- ✓ For more information, see HUD's CPD Notice 99-09 on TA. While this Notice is outdated in its reference to TA being limited to 1% of a grantee's allocation, it still provides an extensive list of eligible TA expenses.
- ✓ Some activities can be classified as either Administration or TA. For example, workshops for state grant recipients on implementing the CDBG program, or on-site TA by State staff.
- ✓ The following activities are ineligible under TA



- General Administrative activities of the State such as monitoring grantees, or developing the Consolidated Plan. For instance, a State cannot use its TA to do an Analysis of Impediments (AI), since it is a general administrative activity of the State. However, it could provide TA to UGLG's to help them identify impediments, or to help them eliminate local impediments.
- State recipients' general administrative costs, such as hiring Grants Administrator.
- Local administrative expenses not related to community development, such as computerizing county personnel records.
- Training of State staff to perform administrative requirements such as ED monitoring of state recipients. While training of State staff in underwriting so that they can make funding decisions is not an eligible use of TA funds, it is an eligible administrative expense.
- Training of entities other than UGLG's and non-profit participants. For instance, training lead based paint contractors is not an eligible use of TA.

#### 16.1.4 Project delivery costs

- ✓ The costs of carrying out an activity by UGLGs include not only goods and services provided by third parties, such as construction contractors, but also include the costs incurred by the UGLG or subrecipient in connection with the use of its own staff and other resources to carry out the activity.
  - For example, if the UGLG 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.
- ✓ UGLG can incur project delivery costs outside of the 20% administrative if State wishes to exclude them. These project delivery costs are considered part of the cost of implementing CDBG activities.
- ✓ There are no State CDBG program regulations that describe "project delivery costs." States can use the Entitlement regulations at 24 CFR 570.206 as interpretive guidance.



### 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 reports to the state, and occasionally assists with general marketing of program activities and Fair Housing.
- ✓ 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).

### 16.1.5 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.

## 16.2 Planning, Administration and TA Cap

Key Topics in This Section	<ul style="list-style-type: none"> <li>✓ Calculating the cap</li> <li>✓ Determining compliance with the cap</li> </ul>
Statutory Citations	106(d) and 24 CFR 570.489
Other Reference Materials on This Topic	<ul style="list-style-type: none"> <li>✓ Guide to National Objectives and Eligible Activities for States – Chapter 2</li> </ul>

- ✓ Planning, administration costs and TA for the state plus all of its UGLG are capped to 20 percent of the sum of grant plus program income plus reallocated funds. The state CDBG planning and Administration cap is described at 24 CFR 570.489 (a)(3).
- ✓ See chart below on Calculating the Planning, TA and Administrative Costs Cap.

	<b>Calculating the Cumulative Planning, TA and Administrative Costs Cap</b>
Total grant amount	\$10,000,000
Program income & reallocated funds	<u>\$500,000</u>
Total: the basis for calculating the cap	\$10,500,000
<i>Multiplied by 20 percent</i>	<u>x 0.20</u>
Maximum dollar level that may be charged to Planning and Program Administration	\$2,100,000
* NOTE: This example is for illustrative purposes only.	

- ✓ With respect to compliance, states will be considered to be in compliance if total state and UGLG expenditures charged under planning, administration and TA are no greater than 20 percent of the sum of the grant for the funding year, reallocated funds, and the program income received by state and UGLGs.
- ✓ However, unlike the entitlement program, the state CDBG program has another type of planning, TA and administrative cap with which it must also comply. The cap above applies to the sum of all CDBG-funded administrative, planning and TA costs for both the



- state and its UGLG. The state itself must comply with another cap on its own administrative, planning and TA costs.
- ✓ That cap is calculated as \$100,000 plus 50% of its administrative, planning and TA costs up to 3% of the grant plus program income plus reallocated costs. Note: the \$100,000 is not counted within the 3% cap.
  - ✓ There are numerous implications of this cap. First, it is important to note that this cap is a subset of the 20% cap, not in addition to that cap. So, it means that CDBG-funded state costs are significantly limited.
  - ✓ Second, the 50% of administrative costs above \$100,000 must be matched. Also, states are responsible for matching CDBG admin expenses dollar for dollar after the first \$100,000. So, the state must have alternate resources to create this match for the administrative, planning and TA costs.
  - ✓ CDBG funds used for administration must be matched at the time the CDBG funds are drawn.
  - ✓ Some States limit UGLGs to a lower percent allowance for program administration or require administration to be a local match.
  - ✓ In the 2004, Congress amended HCDA to allow grantees to spend a larger percentage of CDBG dollars on either administrative/planning costs or TA. However, the total amount spent between the two categories does not exceed 3 percent of the current year's allocation + program income + reallocated funds.
  - ✓ Lastly, the state may decide how to allocate the 3% among administration, TA or planning and thus the more spent on planning, for example, the less that can be spent on administration.
  - ✓ Documenting compliance with the 3% cap is either cumulative, since the inception of the program for open grants from HUD, or another method that demonstrates that the requirement is met. Most states show compliance on an annual basis.
  - ✓ Note that the Administration funds can be spent on any year's program activity, regardless of what program year the funds came from.
  - ✓ The following are examples of calculating the 3% cap:

	<b>Example 1: State TA and Administrative Costs Cap: State spends 100% on admin and none on TA</b>
Total grant amount	\$10,000,000
Program income	<u>\$2,000,000</u>
Total available for admin/planning (if fund only admin) – 3% of \$12,000,000 + \$100,000	<u>\$460,000</u>
Amount that can be unmatched	<u>\$100,000</u>
Amount that must be matched	\$360,000
* NOTE: This example is for illustrative purposes only.	



	<b>Example 2: State TA and Administrative Costs Cap: State spends 75% on admin and 25% on TA</b>
Total grant amount	\$10,000,000
Program income	<u>\$2,000,000</u>
Total available for TA -- 3% of \$10,000,000 X 25%	<u>\$75,000</u>
Total funds available for admin – 3% of \$10,000,000 plus 3% of \$2,000,000 X 75% plus \$100,000	<u>\$370,000</u>
Amount that does not need to be matched	\$100,000 (admin) + \$75,000 (TA)
Amount that does require a match	<u>\$270,000 (admin)</u>
* NOTE: This example is for illustrative purposes only.	

### 16.3 Pre-Award Costs

Key Topics in This Section	<ul style="list-style-type: none"> <li>✓ Requirements</li> <li>✓ Waivers</li> </ul>
Statutory Citations	Regulations at 570.489(b)
Other Reference Materials on This Topic	

- ✓ Under certain conditions, states and UGLG may incur costs prior to the effective date of their CDBG grant agreement.
- ✓ States may permit UGLGs incur project costs before a formal grant relationship between the state and the UGLG exists. If the state permits it, the UGLG can ask for reimbursement of these costs once their grant agreement is executed.
- ✓ The state or UGLG 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. However, states and UGLG should be careful to ensure that these expenditures meet all applicable CDBG and other federal requirements before reimbursing.
- ✓ States may also incur pre-award costs for their costs prior to a grant agreement with HUD.
  - For state administrative costs, the 3% administration, TA, and planning costs are accounted for within an allocation year but are considered to be “yearless”. Thus states are allowed to incur these costs prior to award.
  - For project costs, it is advisable for the State to put a conditional funding clause in their agreements with UGLG and request Field Office permission prior to incurring the cost.



## 16.4 Float-Funded Activities

Key Topics in This Section	<ul style="list-style-type: none"> <li>✓ Description of purpose</li> <li>✓ Requirements</li> </ul>
Statutory Citations	
Other Reference Materials on This Topic	<ul style="list-style-type: none"> <li>✓ Guide to National Objectives and Eligible Activities for States               <ul style="list-style-type: none"> <li>– Making the Most of Your CDBG Resources</li> </ul> </li> </ul>

- ✓ CDBG states have a line of credit that covers the amount of CDBG funds that are available for the state to expend. The state'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 state's line of credit. Under this circumstance, HUD permits states to use a financing technique called float funding.
- ✓ Float loans are not an activity and not included in the list of eligible activities in the HCDA. Float loans are a financing technique that can be used for CDBG eligible activities.
- ✓ Under the float funding provision, the state 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 UGLG 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 state's line of credit. Meanwhile, the state receives an application from a UGLG 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 state has already allocated all of its available CDBG funds to various eligible projects. So, it provides CDBG float funding to the UGLG, 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.
- ✓ The state regulations do not address float funding but states may refer to the entitlement regulations for reference.
- ✓ 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.
  - The state's program must have in place a requirement that program income from the float-funded activities must be repaid.



- Under normal circumstances, the state is not usually permitted to require that a UGLG return program income when the UGLG is conducting “the same activity”. So, the state must narrowly define “same activity” so that the income can be returned.
- The locality must repay the program income back in time for the original activity to occur.
- The state needs a mechanism to ensure that it will definitely get its money back, such as a letter of credit or unconditional agreement from the UGLG with the float funding.
- ✓ The float-funded activity must be included in the Action Plan and Method of Distribution for the year or the Action Plan must be amended.

## 16.5 Revolving Loan Funds (RLF)

Key Topics in This Section	<ul style="list-style-type: none"> <li>✓ Description of purpose</li> <li>✓ Requirements</li> </ul>
Statutory Citations	
Other Reference Materials on This Topic	

- ✓ Revolving loan funds (RLF) are specifically allowed within the CDBG program. Many UGLG 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.
- ✓ It is important to note that RLFs are funded by program income and cannot be capitalized with grant funds.
  - If the UGLG’s program income is used to continue the same activity that generated it, the state must allow the UGLG to keep the program income. However, the CDBG rules apply to the re-use of the money.
  - If the UGLG is doing a different activity from that which generated the PI, the state can require it to be paid to the state but then it cannot be used for an RLF.
  - Thus the state must define “continue the same activity”.
- ✓ Repayments of funds into the RLF are CDBG program income and are subject to all CDBG and other regulatory compliance rules. Thus, the state must have a method for determining compliance.
- ✓ States are required to set other parameters/requirements on local RLFs. However, the following are proposed rule changes to safeguard local RLFs:



- Maintaining contractual relationship for duration of existence of program income;
- Closing out underlying activity, but requiring as a condition of close-out that the UGLG obtain advance state approval of either the UGLG’s plan for use of program income, or of each use of program income by grant recipients via regularly-occurring reports and requests for approval;
- Closing out the underlying activity, but requiring that the UGLG notify the state when new program income is received; and/or
- With prior HUD approval, other approaches that demonstrate compliance.

## 16.6 State Revolving Funds (SRF)

- ✓ A state revolving fund (SRF) is variation of the RLF concept at the state level, using program income returned to the state from state grant recipients.
- ✓ State must establish a revolving fund (usually for economic development) and the state’s method of distribution must provide for this including: grant amounts, application timetable, selection criteria, etc.
- ✓ Repayments from economic development activities go into the SRF rather than into the general pool of program income received by the state.
- ✓ Repayments are used only to make new economic development grant awards.
- ✓ In the short term, SRF program income on hand at the state is used to honor funds requests from local governments for (economic development) activities funded initially out of the SRF. Funds requests for other local activities (e.g. public facilities) are paid out of “regular” state program income or via drawdown from line of credit.

## 16.7 Lump Sum Draw Downs

Key Topics in This Section	<ul style="list-style-type: none"> <li>✓ Description of lump sum draw down purpose</li> <li>✓ Requirements</li> </ul>
Statutory Citations	
Other Reference Materials on This Topic	

- ✓ States may draw down funds from HUD in a lump sum to establish a UGLG rehabilitation fund with one or more private financial institutions for the purpose of financing eligible rehab activities. The reason UGLG 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 state regulations do not cover lump sum draw downs and so states may defer to the entitlement regulations. 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 cannot exceed the grant amount that the state 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:
  - States 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.
    - 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 state in exchange for such deposits. The minimum requirements for such benefits are as follows:
    - States 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 are 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.
  - States 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.

## 16.8 Timely Distribution of Funds

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

Key Topics in This Section	✓ Timely distribution of CDBG funds
Statutory Citations	104(e)(2)
Other Reference Materials on This Topic	✓ Ensuring CDBG Subrecipient Timeliness - Guidelines for State Selection, Management, and Oversight in the Community Development Block Grant Program <a href="http://www.hud.gov/offices/cpd/communitydevelopment/library/timeliness.pdf">http://www.hud.gov/offices/cpd/communitydevelopment/library/timeliness.pdf</a>



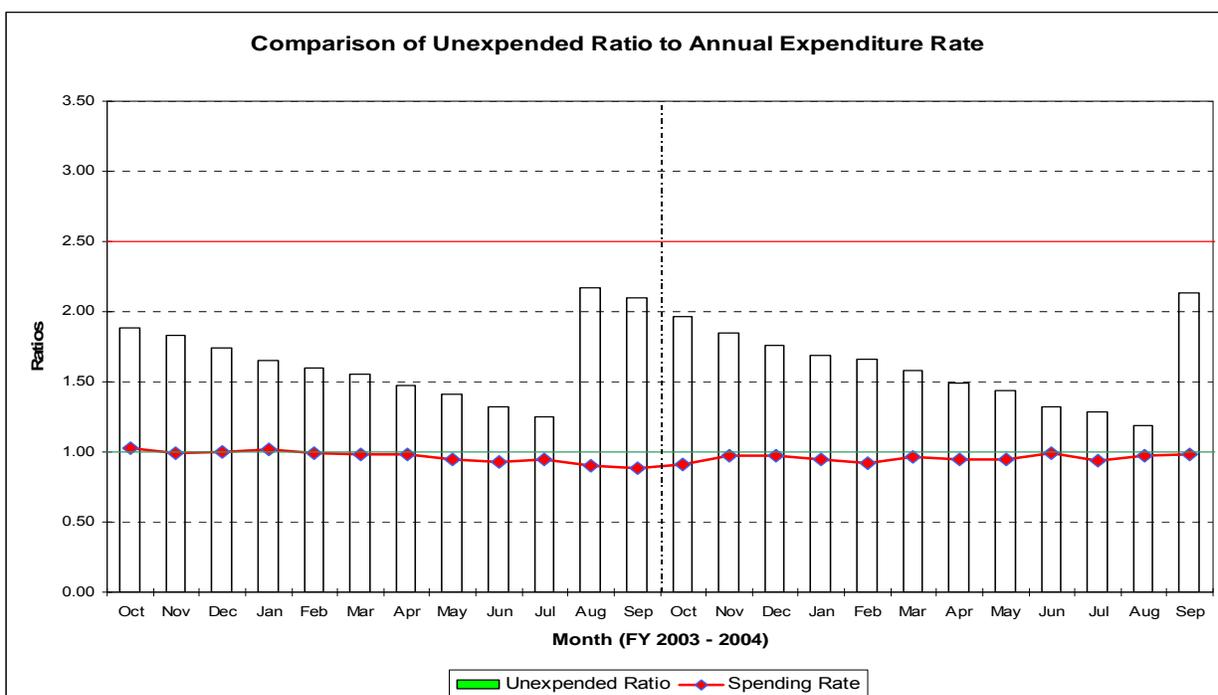
	<ul style="list-style-type: none"> <li>✓ Keeping CDBG Funds Moving Guidelines for managing your overall Community Development Block Grant Program in a timely manner <a href="http://www.hud.gov/offices/cpd/communitydevelopment/library/keepfundsmoving.pdf">http://www.hud.gov/offices/cpd/communitydevelopment/library/keepfundsmoving.pdf</a></li> <li>✓ Methods for Improving Timely Performance for the State Community Development Block Grant Program <a href="http://www.hud.gov/offices/cpd/communitydevelopment/library/statetimeliness.pdf">http://www.hud.gov/offices/cpd/communitydevelopment/library/statetimeliness.pdf</a></li> <li>✓ CPD Notice 06-12: Timely distribution of State CDBG Funds</li> <li>✓ CPD Notice10-03</li> </ul>
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- ✓ Timeliness refers to how quickly the state 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 states make every effort to quickly distribute and use their funds.
- ✓ Under the state program, timeliness is defined as:
  - A state annual grant (excluding state administration) has been obligated and announced to UGLG within 15 months of the state signing its grant agreement with HUD.
  - In addition, HUD encourages states to adopt a goal of obligating and announcing 95 percent of funds to UGLG within 12 months of signing the grant agreement with HUD.
- ✓ “Obligation and announced” means the date on which the state officially announces the selection of its awards to its UGLG. Obligated can be defined by any of the following, for example:
  - Contract;
  - Letter;
  - Press release;
  - News announcement; or
  - Public notice.
- ✓ States should also be able to demonstrate that program income and recaptured funds are distributed as soon as possible under the method of distribution.
- ✓ There is currently no timely expenditure regulatory requirement for the State CDBG program in either the statute or the regulation. However, such a requirement may be established in the future as there is Congressional interest in appropriated funds not spent.
- ✓ HUD tracks state expenditures through the Line of Credit Control System (LOCCS) and it is reported monthly to states. On this State Report, the two most significant indicators are the following (see exhibit 16-1):
  - The “Ratio of Unexpended Funds to Grant” This shows in a bar-graph format the number of years of funds that are unexpended in terms of the latest grant amount. States should pay careful attention to the trend of this ratio; is the ratio increasing over time (not favorable) or decreasing (favorable)? A ratio that increases from year to year because funds in the line of credit are increasing may be an indicator that projects are not on schedule.



- The “Ratio of Funds Expended in the Last 12 Months to Grant” portrays a State’s drawdown rate in the last 12-month period compared to the latest grant amount. If the ratio is less than 1.0, the State is spending less than 1 year’s worth of money per year and the “Ratio of Unexpended Funds to Grant” will eventually increase. Conversely, if the ratio is greater than 1.0, the State is spending more than 1 year’s worth of money per year and the “Ratio of Unexpended Funds to Grant” will eventually decrease. Thus, a spending ratio of 1.0 or above will assure that excess funds do not accumulate in the State’s line of credit.

**Exhibit 16-1: Sample State Report**



- ✓ There are two other reports that are also available to HUD: the Expenditure Report and National Chart. These reports are used to also track state expenditure progress and identify potential issues. States may work with their Local HUD Field Office to obtain these reports and track their timely progress.
- ✓ A state’s program design can also affect timely expenditures including program year start date, method of distribution, state laws and requirements, and the types of activities. The following are examples of ways in which states have ensured funds are spent quickly:
  - Holding 2 years competition at same time;
  - Separating planning from construction grants for large projects;
  - Requiring Environmental review to be complete at time of application; and/or
  - Requiring specific performance / time-frame goals as condition for keeping grant.
- ✓ Refer to the “Methods for Improving Timely Performance” booklet (noted above in resources) for a detailed discussion about how program design can affect timeliness.
- ✓ Additional guidance on timeliness is also available in CPD Notice 05-06.



## 16.9 Program Income

Key Topics in This Section	<ul style="list-style-type: none"> <li>✓ Definition</li> <li>✓ Remission</li> </ul>
Statutory Citations	Regulations at 570.489(e)
Other Reference Materials on This Topic	<ul style="list-style-type: none"> <li>✓ CPD Notice 04-11</li> </ul>

✓ **Program Income Defined:** Program income is the gross income received by the state and its UGLG 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 state (or a UGLG), less costs incidental to the generation of income;
  - 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 an RLF pending its disposition;
  - Interest earned on program income;
  - 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.
  - UGLG or subgrantee income from an ownership interest in a for-profit entity that was assisted with CDBG.
- Program income does not include:
  - Any income received in a single year by a UGLG and its subgrantees, that does not exceed \$35,000; and
  - Amounts generated and kept by a nonprofit development organization under 105(a)(15) under the statute.
- .Program income paid to the state is always program income and is not subject to the \$35,000 exclusion and must be distributed under the method of distribution.
- The state program income should be distributed, as feasible, prior to additional draws from Treasury.
- Program income retained by the UGLG is:
  - Treated as additional CDBG funds subject to all requirements;



- Unless the funds are in an RLF, these funds must be used before requesting additional draws from the state.
  - States must allow the UGLG to keep the program income if it will be used to continue the same activity.
- ✓ See the program income case studies at the end of this chapter.

## 16.10 Uniform Administrative Requirements

Key Topics in This Section	<ul style="list-style-type: none"> <li>✓ Fiscal Controls and Accounting Procedures</li> <li>✓ Cost Principles                             <ul style="list-style-type: none"> <li>- Cost reasonableness</li> <li>- Cost allowability</li> <li>- Cost allocation</li> <li>- Indirect costs</li> </ul> </li> <li>✓ Standards for Financial Management Systems                             <ul style="list-style-type: none"> <li>- Internal controls</li> <li>- Budget controls</li> <li>- Accounting controls</li> <li>- Cash management</li> </ul> </li> <li>✓ Audits                             <ul style="list-style-type: none"> <li>- Type/level of audit required</li> <li>- Scope of audits</li> <li>- Auditor selection/procurement</li> <li>- Audit costs</li> <li>- Audit review and resolution</li> </ul> </li> </ul>
Statutory Citations	<ul style="list-style-type: none"> <li>✓ 24 CFR 570.489</li> </ul>
Other Reference Materials on This Topic	<ul style="list-style-type: none"> <li>✓ 24 CFR Part 85</li> <li>✓ OMB Circular A-87</li> <li>✓ OMB Circular A-133</li> <li>✓ State Audit Requirements Memo  <a href="http://www.hud.gov/offices/cpd/communitydevelopment/programs/stateadmin/CD-BG-memo-single-audit-act-reqts.pdf">http://www.hud.gov/offices/cpd/communitydevelopment/programs/stateadmin/CD-BG-memo-single-audit-act-reqts.pdf</a> </li> <li>✓ CDBG – Toolkit on Crosscutting Issues  <a href="http://www.hud.gov/offices/cpd/communitydevelopment/toolkit/index.cfm">http://www.hud.gov/offices/cpd/communitydevelopment/toolkit/index.cfm</a> </li> </ul>

- ✓ The CDBG regulations require that states and UGLG 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.
- ✓ Non-profits 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.

- ✓ 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”.

### **16.10.1 Fiscal Controls and Accounting Procedures**

- ✓ The CDBG regulations also prescribe the fiscal controls and accounting procedure requirements for states and UGLGs. How these controls and procedures are implemented is primarily state choice, with HUD-specified minimum standards and options. Minimum Standards for expending and accounting for funds must be available for inspection, and adequate to ensure that State CDBG funds are:
  - Used in compliance with statute and regulations,
  - Only spent for reasonable and necessary costs of operating eligible programs, and
  - NOT used to carry out other responsibilities of state and local governments.
- ✓ State Options – States may choose from these fiscal and administrative requirements:
  - The State’s own existing requirements,
  - Adopting new ones, or
  - Applying 24 CFR part 85.

### **16.10.2 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., states/UGLG must treat costs consistently for all grant programs); and
    - Is incurred specifically for the CDBG program;
    - 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 state 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.
    - 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.



### **16.10.3 Standards for Financial Management Systems**

- ✓ States and UGLGs must have financial management systems in place to 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 UGLG, state reporting requirements.
  - Minimize the time elapsing between the transfer of funds from the U.S. Treasury and disbursement by the state or UGLG.
- ✓ States may follow Part 85 or they may develop their own systems and standards that ensure similar accountability.

#### **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.
- ✓ 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 UGLG of CDBG funds must have procedures in place to compare and control expenditures against approved budgets for CDBG-funded activities.
- ✓ A state or UGLG should:
  - 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

- ✓ States and UGLGs 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:
  - **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 UGLGs, with the state;
  - 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.
- ✓ States and UGLGs 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;
  - 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

- ✓ States and UGLG should 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 will curtail unnecessary drawdowns of CDBG funds and minimize the cost of financing the CDBG program by the federal government.
  - Advances to the UGLG to meet the UGLG’s actual cash disbursement.
- ✓ Requirements concerning cash management include the following:
  - States (and UGLG) 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 state 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 UGLG, from the state).
  - 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.

#### **16.10.4 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.
  - States and UGLG 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 state or UGLG 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 state or UGLG 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.
- ✓ States are required to establish a system to track the receipt of annual single audit reports submitted by UGLGs. The following may be involved in tracking these audits:



- Audit information has been received; and
- Audit reports containing findings are being tracked until all issues are successfully resolved.
- ✓ States may consider sending a “Notification of Annual Single Audit” to their UGLGs to determine if they meet the threshold to submit a single audit.
- ✓ A sample tracking template is attached to the September 22, 2008 State Audit Requirements Memo referenced above.

### Scope of Audits

- ✓ Audits performed for states and UGLG 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 statements. This report shall also include an opinion (or disclaimer of opinion) as to whether the state or UGLG 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 state or UGLG 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 state or UGLG, 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 state or UGLG should notify the auditor in writing to extend the retention period.

### Auditor Selection/Procurement

- ✓ In arranging for audit services, states and UGLGs must follow the state's procurement standards, as applicable.
- ✓ Whenever possible, states and UGLGs 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 state from charging Federal awards for the cost of limited scope audits to monitor its UGLGs, provided the UGLG 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 AICPA's generally accepted auditing standards or attestation standards, that are paid for and arranged by the CDBG state 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 state, as a "pass-through entity" under OMB Circular A-133, must perform the following actions with respect to its UGLGs:
  - Identify Federal awards made by informing each UGLG of CFDA title and number, award name and number, award year, and name of Federal agency. When some of this



information is not available, state shall provide the best information available to describe the Federal award.

- Advise UGLGs 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 state.
- Monitor the activities of UGLGs as necessary to ensure that CDBG funds are used for authorized purposes in compliance with laws, regulations, and the provisions of the UGLG agreement and performance goals are achieved.
- Ensure that a UGLG expending \$500,000 or more in Federal awards during the UGLG’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 UGLG’s audit report and ensure that the UGLG takes appropriate and timely corrective action.
- Consider whether UGLG audits necessitate adjustment of the pass-through entity’s own records.
- Require each UGLG 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.

## 16.11 Procurement and Conflict of Interest

Key Topics in This Section	<ul style="list-style-type: none"> <li>✓ Procurement</li> <li>✓ Conflict of Interest</li> </ul>
Statutory Citations	24 CFR 570.489(g) and (h)
Other Reference Materials on This Topic	<ul style="list-style-type: none"> <li>✓ CPD Notice 96-05</li> <li>✓ CDBG – Toolkit on Crosscutting Issues <a href="http://www.hud.gov/offices/cpd/communitydevelopment/toolkit/index.cfm">http://www.hud.gov/offices/cpd/communitydevelopment/toolkit/index.cfm</a></li> </ul>

### 16.11.1 Procurement

- ✓ Procurement is primarily dictated by state choice, with HUD-specified minimum standards. Procurements by the state follow the state’s own procurement policies. The state must also establish procurement requirements for units of local government. The state can also adopt the procurement requirements in 24 CFR Part 85; however, this is not a requirement.
- ✓ Minimum standards must involve the following:
  - Promote full and open competition.
  - Specify applicable methods of procurement (small purchase, bids, etc.) Cost plus percentage of costs and percentage of construction cost methods are NOT ALLOWABLE.



- Include standards of conduct for employees engaged in award or administration of state CDBG-funded contracts.
- Must ensure that all purchase orders and contracts include all applicable references to statutes, regulations, Executive Orders.
- ✓ Please note that subrecipient arrangements and awarding CDBG funds to another governmental entity (e.g. a council of governments (COG)) is not subject to procurement, but is subject to the state's method of distribution (MOD).

### **16.11.2 Conflict of Interest**

- ✓ Conflict of interest requirements are specified by HUD; however, these will also be dictated by state and local law. States must ensure compliance by reviewing local government situations and determining if the decision-making process was followed appropriately to ensure HUD as well as state and local standards are followed.
- ✓ A state's standards of conduct apply to all procurement activities.
- ✓ All non-procurement activities (acquisition and disposition of property, direct assistance to individuals, businesses) are subject to the HUD requirements described in 570.489(h).
- ✓ The general rule is persons acting on behalf of state or local government in a State CDBG decision making role or who are in a position to gain inside information (and their family members) cannot obtain a financial interest or benefit from State CDBG funded activities.
  - Prohibition ends 1 year after the decision-making person has left their position.
- ✓ HUD evaluates and decides the outcome of a state's request for exception for state employees or agents.
- ✓ The state evaluates and decides the outcome of a UGLG or other recipient on behalf of their employees or agents.
- ✓ The regulations contain a list of factors to be included in requests, and considered when evaluating them.
  - Whether the exception would provide a significant cost-benefit or essential degree of expertise that would otherwise be missing;
  - Whether an opportunity was provided for open competitive bidding;
  - Whether the person affected is a member of a group or class of low- or moderate-income persons intended to be the beneficiaries, and the exception will allow the person to receive the same benefits as other members of the class;
  - Whether the person has withdrawn from the role of decision- maker;
  - Whether the interest or benefit was present before the affected person became an (h)(3) covered person;
  - Whether undue hardship will result to the State, UGLG or affected person when weighed against the public interest;
  - Any other relevant considerations; and/or
  - Request for exception must include public disclosure & attorney opinion that exception does not violate state or local law.



## 16.12 Change of Use

Key Topics in This Section	✓ Change of use requirements
Statutory Citations	Regulations at 570.489(j)
Other Reference Materials on This Topic	

- ✓ The standards described in this section apply to real property within the state or UGLG's control that was acquired or improved, in whole or in part, using CDBG funds in excess of \$100,000. 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 state or UGLG 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 the state and UGLG provide 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 state and UGLG determine, 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 state'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.



## Attachment 16-1: Program Income Case Studies

### The State of XYZ

The State of XYZ's CDBG program includes a variety of program income generating activities. XYZ's measurement period for determining program income is the same as its program year, which runs April 1 – March 31. Program income earned on the state-level regional fund activities is returned to the State.

XYZ also requires the return of the CDBG portion of proceeds from the sale of property acquired with or improved by the use of CDBG funds if these assets are disposed of prior to the final closeout of XYZ's grant to the unit of general local government *unless* the property sale and reuse of income by the jurisdiction were integral parts of the project in the jurisdiction's application as originally submitted and approved by the State.

During the most recent measurement year, the following income items were received by, or returned to, the State of XYZ –

- \$142,000 in principal and interest payments on economic development loans eligible under the state-established Eastern ED Revolving Fund.
- \$28,000 in principal and interest payments on economic development loans eligible under the state-established Western ED Revolving Fund.
- \$20,000 proceeds from property sale returned by the Town of Whyknot. The Town determined subsequent to their application and land purchase that a portion of the land acquired could be sold as an excess lot without negatively affecting the project. This represented the *only* income generated by Whyknot's activities during the year.

#### Mosquito Junction

Mosquito Junction received funding from the State of XYZ's CDBG program for two homeowner rehabilitation projects. In the first case, the city set up a homeowner rehabilitation revolving loan fund. In the second case, deferred loans were subject to 100% repayment for a 20-year period. During the most recently completed year, the following income items were received and retained by Mosquito Junction –

- \$100,000 repayment of a loan made from Mosquito Junction's revolving loan fund, awarded during the State's FY 2003 cycle. While the project was awarded in 2003, due to unanticipated project difficulties, the rehabilitation work on the 5 homes was not completed until late 2006. A new developer purchased all 5 homes in order to obtain land for a Superstore parking lot (not a CDBG- eligible or assisted project). The original owners made significant profits on their properties, but also triggered the CDBG repayment requirements.
- \$17,000 repayment of a non-RLF deferred rehabilitation loan from Mosquito Junction's FY 2004 activity. This homeowner was transferred to a job in Metropolis, and sold the home at fair market value to an unrelated purchaser.



### Pumpkinsmash County

Pumpkinsmash County has received and successfully administered several State CDBG grants and other CPD funding since 2005. The County had one open grant during the measurement year, for Phase II of its regional water and sewer system. This activity is in the early engineering and design stage. Both water and sewer projects were 100% CDBG-funded. During the most recently completed year, the following income items were received and retained by Pumpkinsmash County and its “subrecipients” –

- \$24,000 in tap fees collected from 24 non-LMI households served by Phase I of the regional water and sewer system.
- \$2,000 received by the County as repayment of an original \$20,000 deferred rehabilitation loan. The County’s program reduces a homeowner’s repayment liability by 10% a year over a 10-year period.
- \$100 in interest earned on the County’s revolving rehabilitation loan fund account.
- \$10,000 received by Pumpkinsmash CDC, a nonprofit development organization, for activities eligible under 105(a)(15) of the HCDA Act.

Part A – Answer the following questions relating to income received by or returned to the State of XYZ:

1. What is the total amount of program income directly received by and/or returned to XYZ during the year?
  
2. XYZ has received and approved a \$200,000 request from Possum Kingdom to fund an activity eligible under the Western ED revolving fund criteria. This is the sole reimbursement request in for processing at this time. Assuming the program income amounts listed above are on hand at the time of the request, how much of the request will be provided by –
  - Eastern ED fund program income?
  - Western ED fund program income?
  - Town of Whyknot program income?
  - Additional CDBG funds drawn from the Treasury?
  
3. What other questions or special considerations, if any, could state staff or HUD monitors raise related to the Town of Whyknot’s income?



Part B – Answer the following questions relating to income received and retained by Mosquito Junction:

1. What is the total amount of program income received and retained by Mosquito Junction during the year?
  
  
  
  
  
  
  
  
  
  
2. What information do state staff and/or HUD monitors need to have in order to determine if income was potentially generated by a homeowner rehabilitation project?

Part C – Answer the following questions relating to income received and retained by Pumpkinsmash County:

1. What is the total amount of program income received by Pumpkinsmash County and its “subrecipients” during the year?
  
  
  
  
  
  
  
  
  
  
2. What information might state staff and/or HUD monitors need to have in order to make final determinations about whether the income received by the CDC and the Artisan’s Market is potential program income?
  
  
  
  
  
  
  
  
  
  
3. How many years after rehabilitation did the homeowner occupy his home?
  
  
  
  
  
  
  
  
  
  
4. BONUS QUESTION – Why is the interest earned considered program income, rather than being required to be returned to the Treasury?