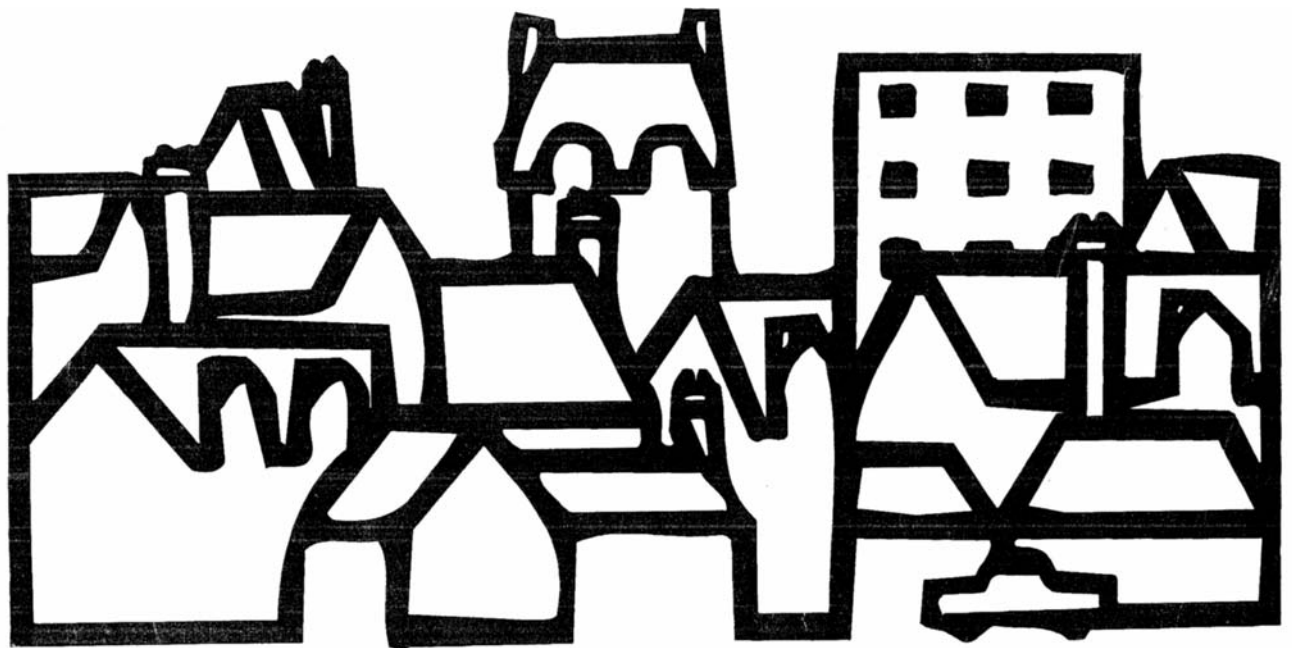




Playing by the Rules

A Handbook for CDBG Subrecipients on Administrative Systems

March 2005



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A Handbook for CDBG Subrecipients on Administrative Systems

U.S. Department of Housing and Urban Development
Office of Community Planning and Development
Community Development Block Grant Program

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PROLOGUE: A MESSAGE TO CDBG SUBRECIPIENTS

As Community Development Block Grant (CDBG) subrecipients, you are an indispensable part of the CDBG Entitlement program. You provide grantees and the U.S. Department of Housing and Urban Development (HUD) with assurance that the diverse communities, groups, and individuals whom the CDBG program is intended to serve are in fact reached by the program. Your participation provides:

- Access to, and knowledge of, the specific neighborhoods and beneficiaries served by the program.
- Technical and managerial capabilities that might not otherwise be available to grantees.
- A mechanism for assuring citizen participation by involving the intended beneficiaries in the design and delivery of those services.

Without your continued involvement and support, the CDBG program could not address the broad range of needs in our communities. Whether you are a governmental agency, a non-profit organization, or a for-profit entity, HUD and the more than 1,000 CDBG Entitlement grantees count on you to make sure that needed services are delivered in a cost-effective way. This is not an easy task. Despite numerous accomplishments in program delivery, many of you have encountered administrative problems in achieving your mission; hence, the motive for this handbook.

Common Subrecipient Problems

The majority of difficulties experienced by subrecipients lay in the area of financial management, administrative systems, documentation, and record keeping. Many of these problems are attributed to:

- Limited experience in dealing with Federally-funded programs.
- Lack of adequate staffing or financial resources available on a consistent basis.
- Limited understanding about how to meet the complex administrative requirements that must be satisfied in using Federal funds for CDBG activities.
- Limited oversight, communication, or management support from grantees.

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Subrecipient Responsibilities

You and your grantees share joint responsibility for carrying out permitted activities in conformance with applicable Federal requirements. Grantees and subrecipients are partners. Both partners must accept the fact that there is no such thing as a “free lunch.” In return for Federal funding, grantees and subrecipients agree to comply with the laws and regulations governing the use of those funds. A central principle is that most of the Federal requirements imposed on the grantee are passed along to you, the subrecipient. As more experienced subrecipients can attest, the more you know about the rules, the more efficient you can be in designing and conducting your activities. Playing by the rules does not detract from your performance; it enhances it (and enables you to continue receiving funds).

Regulatory compliance and performance go hand-in-hand. Performance measurement is an effective management technique that enables grantees to analyze the benefits of their investments. It is a mechanism that tracks the progression of projects and evaluates their overall program effectiveness. The CDBG program requires that each grantee submit a performance and evaluation report concerning the use of CDBG funds, together with an assessment of the relationship of the use of funds to the objectives identified in the grantee’s Consolidated Plan. Subrecipients should also establish goals and measure their performance in a manner consistent with the grantee’s performance measurement system.

In using Federal funds the cardinal rule is: **documentation**. The achievement of program goals and the completion of activities must be supported by adequate documentation of the facts. If your activities, personnel, procedures, expenditures, and results are not documented properly, from the Federal Government’s perspective, you have not done your job, *regardless of your accomplishments*. Appropriate records are the lifeblood of all successful CDBG agencies.

Finally, successful CDBG programs depend upon the commitment of grantees and subrecipients to **effective management practices**. These include: (1) supporting cooperative, problem-solving relationships among HUD, grantees, and subrecipients; (2) working toward continuous improvement in regulatory compliance and timely program performance; (3) maintaining open and frequent communications among all participants; and (4) focusing on preventing problems first, rather than curing them later. Such a commitment to effective management will assure that the “minimum requirements” specified in the handbook and the training do not become “maximums” for either grantees or subrecipients.

This handbook is designed to help you understand the administrative requirements that apply to the use of Federal funds for the delivery of CDBG programs and activities. Not surprisingly, you will find the bulk of these requirements reflect common sense and good business practices, like balancing your checkbook or shopping for the lowest price. We hope that what you learn from this handbook about meeting CDBG administrative requirements will save you from major headaches later on.

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You will also recognize that most of the standards presented in this handbook represent the *minimum requirements* prescribed by Federal regulations, not *optimum* or *maximum*. Therefore, we hope your agency will resist the temptation to allow these standards to become “maximums” for its activities, but rather, will seek to use these regulations as a path to optimum performance and full achievement of all your goals.

This handbook had not been updated since its first printing in 1993. The changes currently being made reflect the incorporation of OMB Circulars A-102 and A-110 into the HUD Common Rule at 24 Code of Federal Regulations (CFR) Parts 84 and 85, as well as changes to the CDBG regulations that were made between 1993 and 2003.

Experience has shown that activities undertaken by subrecipients are potentially high risk. Many subrecipients have excellent intentions but use volunteers or inexperienced staff who don't know Federal requirements. In our efforts to promote timely expenditure of CDBG funds, we also found that delays in subrecipient activities were a cause for grantee failure to comply with the timeliness requirements at 24 CFR 570.902.

Over 10 years have passed since CPD first issued the three related publications dealing with subrecipients. This material is now being updated because in the intervening years, some administrative requirements have changed, grantees and subrecipients have experienced staff turnover, and new subrecipients are participating in the program. It is again time to focus grantees' attention on their responsibilities for subrecipient oversight and to encourage entitlement communities to take a fresh look at their internal processes for subrecipient selection, training, management, and monitoring.

This is an opportunity for grantees to distribute copies of Playing by the Rules to all their subrecipient organizations and to conduct training for both grantee and subrecipient staff, using the newly issued Training CDBG Subrecipients in Administrative Systems as a guide. Because both these publications are available from the HUD Web site^{*}, it has been made easier for grantees to distribute materials and to conduct this training. In addition to promoting program compliance, the sound management practices advocated in these publications can also serve to facilitate the development of performance measures for project implementation. Such actions will result in improved delivery of CDBG programs to the intended program beneficiaries, the low- and moderate-income residents of the community.

^{*}<http://www.hud.gov/offices/cpd/communitydevelopment/library/index.cfm>

CHAPTER 1.0: INTRODUCTION

The purpose of this handbook is to provide subrecipients of CDBG Entitlement funds with an explanation of the basic administrative requirements of the CDBG program. A “**subrecipient**” is a public agency, a private non-profit organization, in some circumstances a Community-Based Development Organization (CBDO), or perhaps even a for-profit entity that has been provided CDBG funds by the local “grantee” (the city or county) to carry out agreed upon activities that are eligible under the Federal regulations. While you may not technically meet the CDBG definition of a “subrecipient,” your grantee may want to treat you like one to achieve its own objectives. In the administration of its CDBG funds, each subrecipient must meet the administrative requirements covered in this handbook.

The CDBG Entitlement program for metropolitan cities and urban counties is a “block grant” program. Through the block grant approach, the Federal Government offers localities a great deal of flexibility in the way they may use their funds, and in the activities they support, either directly or through subrecipients.

Since the start of the CDBG program over 30 years ago, HUD has issued numerous rules and regulations governing the program to ensure that the intent and requirements of the law are fulfilled, and that the opportunities for fraud, waste, mismanagement, and abuse of program resources are minimized. Although the regulations cover administrative and program requirements for both grantees and subrecipients, **this handbook is primarily concerned with:**

- The regulations that apply to internal management and financial systems of subrecipients; and
- Subrecipients’ responsibilities to document and report their CDBG-funded activities.

The administrative systems that are the subject of this handbook are *critical* to a subrecipient’s ability to comply with CDBG program requirements. For example, a non-profit organization may indeed be providing highly effective public services to its low-income clientele; but it is only through its record-keeping and financial systems that the subrecipient will be able to justify its use of CDBG funds by showing that the activities were both eligible and consistent with its Subrecipient Agreement with the grantee, and that its expenses were appropriate and allowable under the program guidelines.

For those subrecipient organizations having little prior experience with Federal grant programs, the complexity of regulations that mandate specific procedures (“means”) for achieving program objectives (“ends”) can be daunting. The emphasis on specific procedures and extensive record keeping may appear on the surface to be bureaucratic red tape. However, many of the required systems and procedures are based on widely-accepted standards for good business practices that

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are extensively observed in the private sector. They are also designed to help ensure that every entity administering CDBG funds has basic management controls and financial safeguards in place to reduce the likelihood of mismanagement in the use of public funds. With the oversight and analytic capacity that these systems provide, many program managers find they are able to adjust their operations continuously and improve their performance on a regular basis.

1.1 How to Use This Handbook

This Handbook is organized into chapters corresponding to particular components of a subrecipient's administrative operations:

- Financial Management (Chapter 2.0).
- Procurement and Contracting (Chapter 3.0).
- Property Management and Disposition (Chapter 4.0).
- Record-Keeping and Reporting Requirements (Chapter 5.0).
- Other Administrative and Program Requirements (Chapter 6.0).
- Audits (Chapter 7.0).
- Closeout (Chapter 8.0).

Each chapter begins with a brief explanation of the underlying management principles that apply to that facet of program administration, followed by the basic standards that must be met as specified in the applicable regulations or circulars.

It is important to note that sometimes differences exist in the specific requirements for governmental versus nongovernmental subrecipients. In such cases, the set of requirements that is generally more stringent or detailed is described first and then any exceptions to such rules are discussed. For example, the rules for procurement spelled out in Parts 84 and 85 of Title 24 of the Code of Federal Regulations (CFR) for nongovernmental and governmental subrecipients, respectively, distinguish how the rules differ depending on the type of subrecipient. Therefore, the chapter on procurement first outlines the requirements of 24 CFR Part 85 for governmental subrecipients and then discusses how those in Part 84 for nongovernmental subrecipients differ.

To the extent feasible, performance standards have been listed in order from the most basic requirements to the most specialized. This has been done to facilitate use of the handbook as a

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checklist for building administrative systems “from the ground up,” and/or for reviewing existing systems for their adequacy in meeting the standards.

Subrecipients (and grantees) are cautioned to use this handbook as a supplement to, not a replacement for, the applicable regulations. It is assumed that the reader has access to, or copies of, the basic regulations identified in Section 1.2, which follows. Over time, use of the handbook as a reference tool should help the recipient de-mystify the regulations and become more familiar with the requirements of the CDBG program. This knowledge, in turn, should assist the subrecipient avoid the pitfalls (and penalties) of noncompliance.

Readers of this handbook may notice some duplication from chapter to chapter. This reflects the overlap that occasionally occurs in the regulations themselves and was retained in the text to minimize the amount of cross-referencing.

1.2 Summary of Principal Regulations Governing CDBG Administrative Systems

The key regulations that form the basic administrative requirements of the CDBG Entitlement program are summarized here to acquaint the reader with the various sources for the following standards described throughout the remainder of this handbook. At the end of this chapter, Exhibit 1–1 describes the regulatory framework for the CDBG program. Regulations are developed in response to, or in fulfillment of, Federal statutes that govern the CDBG Entitlement program, both those specific to the CDBG program and those addressing other Federal laws or policies that apply to the CDBG program (e.g., National Environmental Policy Act, Americans with Disabilities Act, Davis-Bacon Act).

The basic program regulations governing management and financial systems for the CDBG program are contained in **24 CFR Part 570, Subparts J and K**. They are applicable both to grantees and subrecipients in the public and private sectors:

- a) **Subpart J (24 CFR 570.500–570.513)** addresses general responsibilities for grant administration, including the applicability of uniform administrative requirements, provisions of Subrecipient Agreements, program income, use of real property, record keeping and reporting, and closeout procedures.

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- b) *Subpart K (24 CFR 570.600–570.613)* deals with **other program requirements** of the CDBG program, including civil rights; labor standards; environmental standards; flood insurance; relocation; displacement; acquisition; employment and contracting opportunities; lead-based paint; use of debarred, suspended, or ineligible contractors; uniform administrative requirements and cost principles; and conflicts of interest.

In addition to the basic regulations of the CDBG program contained in 24 CFR Part 570, there are three other categories of requirements that affect the administrative systems and procedures subrecipients must have in place to receive support:

- Federal regulations governing administrative and audit requirements for grants and cooperative agreements (governmental subrecipients) for which HUD has oversight responsibilities.
- Administrative circulars from the Office of Management and Budget (OMB) and Department of the Treasury governing cost principles, administrative systems, fiscal procedures, and audit requirements for grantees and subrecipients.
- Executive Orders from the Office of the President implementing various equal employment opportunity and environmental policies.

The applicability of these administrative requirements depends upon the public or private status of the organization receiving funds. **For subrecipients that are private, *non-profit organizations*,¹ the key regulations defining administrative requirements are:**

24 CFR Part 84 “Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-profit Organizations”²: These regulations implement OMB Circular A-110 and specify standards relative to cash depositories, bonding and insurance, retention and custodial requirements for records, financial management systems, monitoring and reporting on performance, property management, and procurement.

¹ For-profit entities organized pursuant to Section 301(d) of the Small Business Investment Act of 1958 (15 U.S.C. 681(d)) and for-profit local development corporations (LDCs) may also qualify as CBDOs under the requirements of 24 CFR 570.204 and thus serve in the role of a subrecipient under the CDBG program if so designated by the grantee. The CDBG regulations pertaining to non-profit organizations apply to such for-profit entities.

² Not all the requirements of 24 CFR Parts 84 and 85 are applicable to CDBG subrecipients; 24 CFR 570.502(a) and (b) specify the sections and paragraphs of the Common Rule that apply to CDBG recipients and subrecipients.

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OMB Circular A-122 “Cost Principles for Non-profit Organizations”: A publication of OMB, this document establishes principles for determining costs that are allowed to be charged to Federal grants, contracts, and other agreements with non-profit organizations (except educational institutions). The principles are designed to ensure that the Federal Government will bear its fair share of costs except where restricted or prohibited by law.

OR,

OMB Circular A-21 “Cost Principles for Educational Institutions”: This document covers much of the same subject matter as OMB Circular A-122, only it is aimed at educational institutions (public and private).

AND,

OMB Circular A-133 “Audits of States, Local Governments and Non-profit Organizations”: This circular defines audit requirements for both governments and non-profits receiving Federal funds. The document addresses mandated frequency and scope of audits, allowability of audit costs, and the process of auditor selection.

For “governmental subrecipients” (*a public agency that is independent of the grantee government, such as a public housing authority, parks commission, or a jurisdiction cooperating with an urban county CDBG grantee*³), **the key administrative requirements are:**

24 CFR Part 85 “Uniform Administrative Requirements for Grants and Cooperative Agreements to State, Local, and Federally-recognized Indian Tribal Governments” (also known as “the Common Rule”)²: For governmental entities and public agencies, Part 85 of Title 24 of the CFR details standards for financial management systems, payment, allowable costs, property management, procurement, monitoring and reporting program performance, financial reporting, record retention, and termination.³

OMB Circular A-87 “Cost Principles for State and Local Governments”: For governmental entities receiving CDBG or other Federal funds, this document is the equivalent of OMB Circular A-122. The circular establishes the principles for determining the allowable costs of programs administered by public entities under grants or contracts from the Federal Government. The principles are designed to provide the basis for a uniform approach to determining costs and to promote efficiency.

³ Under the CDBG program, participating units under an urban county are considered to be part of the grantee; however, the grantee is responsible for applying the same requirements to these participating jurisdictions as are applicable to subrecipients.

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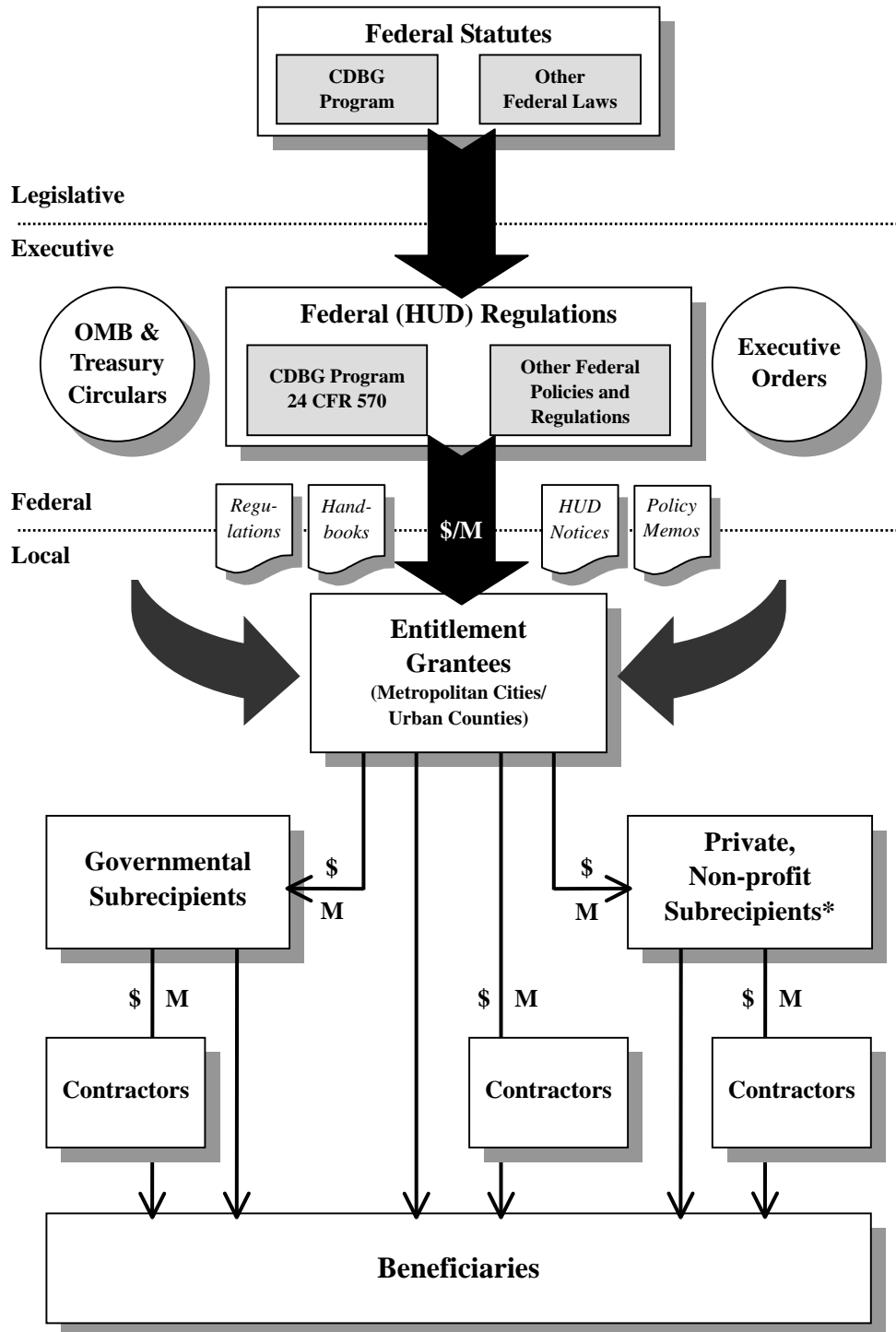
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OMB-133 “Audits of State, Local Governments and Non-profit Organizations”:

For state and local governments which receive Federal aid, this document describes audit requirements, including frequency and scope of audit, audit standards, and auditor selection procedures.

The above referenced sections of Title 24 regulations and OMB circulars may be accessed at the HUD Web site at <http://www.hudclips.org/cgi/index.cgi>.

Exhibit 1-1: Regulatory Framework for CDBG Entitlement Program



\$=Funds provided. M=Monitoring required. *Includes §204(c)(2) for-profit CBDOs.

CHAPTER 2.0: FINANCIAL MANAGEMENT

When subrecipients first begin providing services under the CDBG program and drawing down funds, few have financial systems in place that meet all pertinent Federal requirements. For many of you, putting together a financial system both that serves your needs and meets Federal requirements may have been a matter of trial and error. This kind of “ad hoc” approach is dangerous, however, because you may not find out about the inadequacies of your system until it is too late, such as when you run into a major problem with an overspent budget or a serious audit finding.

This chapter provides you with a summary of the required elements of financial systems for managing Federal funds. Before you plunge into the details of the Federal requirements, you may want to ask yourself the following eight sets of questions to find out if there are *particular* areas where you may need help.

- 1) Internal controls:** Does your agency have a written set of policies and procedures that define staff qualifications and duties, lines of authority, separation of functions, and access to assets and sensitive documents? Does your agency have written accounting procedures for approving and recording transactions? Are financial records periodically compared to actual assets and liabilities to check for completeness and accuracy?

- 2) Accounting records:** Does your agency maintain an adequate financial accounting system, the basic elements of which should include: (a) a chart of accounts, (b) a general ledger, (c) a cash receipts journal, (d) a cash disbursements journal, (e) a payroll journal, (f) payable and receivable ledgers, and (g) job cost journals (if involved in construction)? Does your accounting system provide reliable, complete, and up-to-date information about sources and uses of all funds? Are “trial balances” performed on a regular basis (at least quarterly)?

- 3) Allowable costs:** Does your agency have a clearly defined set of standards and procedures for determining the reasonableness, allowability, and allocability of costs incurred that’s consistent with the basic Federal rules (OMB Circulars A-87 or A-122)? Does your agency know which specific types of expenditures are prohibited under the CDBG program? Does your agency have an approved indirect cost allocation plan?

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- 4) Source documentation:** Does your agency maintain up-to-date files of original source documentation (receipts, invoices, canceled checks, etc.) for all of your financial transactions, including those involving obligations incurred and the use of CDBG program income?
- 5) Budget controls:** Does your agency maintain an up-to-date (approved) budget for all funded activities, and perform a comparison of that budget with actual expenditures for each budget category? Does your agency regularly compare progress toward the achievement of goals with the rate of expenditure of program funds?
- 6) Cash management:** Does your agency have a regular procedure for accurately projecting the cash needs of the organization that will serve to minimize the time between the receipt of funds from the grantee and their actual disbursement? Can your agency ensure that all CDBG program income is used for permitted activities, and that such program income is used before further drawdowns are made from the grantee for the same activity?
- 7) Financial reporting:** Is your agency able to provide accurate, current, and complete disclosure of the financial results of each Federally-sponsored project or program in accordance with the reporting requirements of the grantee and HUD?
- 8) Audits:** When was your last Independent Public Accountant (IPA) audit and what were the results? Does your agency have a copy of the management letter?

If your answer is “yes” to all of these questions, then your agency has established a laudable degree of control over its financial affairs. If you were not able to give an affirmative answer to all of the questions in the preceding section, then this chapter will help you to understand the minimum Federal requirements for financial management and to identify where your systems need strengthening. Once these areas have been identified, you can work with your financial staff, your auditor and/or your grantee to develop the systems and expertise you need to gain control of your agency’s financial affairs and meet the Federal requirements.

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AS YOU READ THIS CHAPTER, THINK ABOUT ...

1. Checking your systems against the standards described here.
2. Reviewing the capabilities of your current bookkeeping or accounting staff to fulfill their responsibilities under these requirements, and listing the areas where they may need support.
3. Talking to your present accountant/auditor to find out if he or she has fully evaluated the adequacy of your systems and is familiar with the requirements outlined here.
4. Getting the names of people to contact in your grantee's agency (e.g., city or county Community Development agency) who can answer questions and help you strengthen your systems.
5. Paying attention to any warning signs that may signal a need for help (for example, unexplained expenditures, unrecorded program income, expenditures occurring much more rapidly than progress is attained.)

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2.1 Overview

The requirements for financial management systems and reporting are found in **24 CFR Part 85.20 for governmental subrecipients**¹ and in **24 CFR Part 84.21-28 as amended by 570.502**, for non-profit subrecipients. The purpose of these requirements is to ensure that a subrecipient receiving Federal funds has a financial management system sufficient to:

- a) Provide effective control over and accountability for all funds, property, and other assets.
- b) Identify the source and application of funds for Federally-sponsored activities, including verification of the “reasonableness, allowability, and allocability” of costs and verification that the funds have not been used in violation of any of the restrictions or prohibitions that apply to this Federal assistance.
- c) Permit the accurate, complete, and timely disclosure of financial results in accordance with the reporting requirements of the grantee or HUD.
- d) Minimize the time elapsing between the transfer of funds from the U.S. Treasury and disbursement by the subrecipient.

The Federal regulations provide specific requirements in connection with the eight areas previously identified in this chapter, namely, internal controls, accounting records, allowable costs, source documentation, budget controls, cash management, financial reporting, and audits. The first seven areas are discussed in Sections 2.2 to 2.8. Auditing standards are described separately in Chapter 7.0.

2.2 Internal Controls (see 24 CFR 85.20(b)(3) and 84.21(a)(3))

The soundness of any organization’s financial management structure is determined by its system of internal controls. **“Internal controls” consist of a combination of procedures, specified job responsibilities, qualified 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 agency’s management can ensure that:

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

¹ Paragraph (a) of 24 CFR 85.20, however, does not apply to subrecipients, but only to states that are recipients of Federal funds. (Per 570.502(a)(4)).

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- These resources are protected against waste, mismanagement, or loss.
- Reliable information on the source, amount, and use of resources are secured, up-to-date, and recorded.

Accordingly, some of the basic elements that a subrecipient should consider in developing its system of internal control include:

- An ***organizational chart*** setting forth the actual lines of responsibility of individuals involved in approving or recording financial transactions.
- ***Written definition of the duties*** of key employees.
- ***A formal system of authorization and supervision*** sufficient to provide accounting control over assets, liabilities, receipts, and expenditures. This should include:
 - Maintenance of a policy manual specifying approval authority for financial transactions and guidelines for controlling expenditures.
 - Written procedures for the recording of transactions as well as an accounting manual and a chart of accounts (see Accounting Records, in the following section).

The system of authorizations should provide a way for management to ensure supervisory approval of transactions and documentation of these transactions for accounting purposes. A system of authorizations can be general, as in a procedures manual that explains how accounting functions are to be performed, or very specific, as in identifying who has the authority to sign a contract on behalf of the organization or to sell a piece of equipment.

- Adequate ***separation of duties***, so no one individual has authority over an entire financial transaction. Separation of duties specifically involves the separation of three types of functional responsibilities: (a) authorization to execute a transaction, (b) recording of the transaction, and (c) custody of the assets involved in the transaction. No one person should have control of more than one of these functional responsibilities.²

² It is often beneficial to have different individuals or even different departments handle the various steps in the processing of transactions. First, separation of functional responsibility results in cross-checking by the individuals involved, increasing the likelihood that errors will be discovered and corrected. Second, fraud is more difficult to carry out if it requires the collusion of two persons or more. In organizations with very limited staff, however, it may

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- Hiring policies to ensure that *staff qualifications* are commensurate with job responsibilities.
- ***Control over access to assets, blank forms, and confidential documents.*** Physical access to records, blank forms, cash, and other assets should be limited to authorized personnel only. For example, access to accounting records should be limited to only those individuals having record-keeping or supervisory responsibility for them.
- Periodic ***comparisons of financial records to actual assets and liabilities (reconciliation)***, with corrective action taken in response to any discrepancies. As with separation of duties, this is a crucial exercise to uncover and correct inadvertent record-keeping errors in a timely manner. It is also essential for identifying potential weaknesses in an organization's system for safeguarding resources as well as possible instances of fraud or misuse of assets.

2.3 Accounting Records (see 24 CFR 85.20(b)(2) and 84.21)

Subrecipients are required to have ***accounting records that adequately identify the source and application of CDBG funds*** provided to them. To meet this requirement, a subrecipient's accounting system should include at least the following elements:

- ***A chart of accounts.*** This is a list of names and the numbering system for the individual accounts that contains the basic information about particular classifications of financial transactions for the organization. Accounts are created and, in turn, used to summarize the financial transaction data, according to some common characteristics. For example, a typical chart of accounts might have separate account categories for describing assets (cash in a checking account, accounts receivable, prepaid insurance, etc.); liabilities (loans, accounts payable, obligated funds, etc.); revenue (drawdowns from CDBG awards, cash contributions, proceeds from sales, other program income, etc.); and expenses (rent, wages, heat, telephone, etc.).
- ***A cash receipts journal.***³ This journal documents chronologically when funds were received, in what amounts, and from what sources.

be difficult to achieve optimal separation of duties. In such instances, the most critical functional areas are separation between custody for cash, record keeping for cash, and control of assets easily converted to cash.

³ A journal is a chronological record of transactions showing the charges to be recorded as a result of each transaction. Every transaction is initially recorded in a journal. Therefore, a journal is called a record or book of original entry. Each entry in the journal states the names of the individual accounts to be debited and credited, the dollar amount of each debit and credit, the date of the transaction, and any other necessary explanation of the transaction. The act of entering a transaction in a journal is called "journalizing." Information for a journal entry can originate from a variety of sources, such as checks issued or received, invoices, cash register tapes, and time sheets.

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A cash disbursements journal. This journal documents chronologically the expenditures of the organization (e.g., when the expense was incurred, how much was spent, to whom funds were paid, and for what purpose).

- *A payroll journal.* This journal documents the organization’s expenses on salaries and benefits and distinguishes different categories for regulatory purposes.
- *A general ledger.* After a transaction is entered in a journal, that information also should be transferred to the proper accounts contained in the general ledger. The general ledger summarizes chronologically the activity and financial status of all the accounts of an organization. The process of transferring transaction information from a journal to a ledger is known as “posting.” The entries in the journal and ledger should be cross-indexed to permit the tracing of any recorded transaction (i.e., an “audit trail”).

Periodically, a “trial balance” is performed, to test the mathematical accuracy of the ledger and to prepare a statement of the financial position of an organization as of a particular date.

Sources and Uses of Funds

For the CDBG program, these *accounting records must contain reliable and up-to-date information* about the sources and uses of funds, including:

- Federal **grant awards** (or subgrant allocations) received by the organization.
- **Current authorizations and obligations** of CDBG funds.
- **Unobligated balances** (funds remaining available for distribution).
- **Assets and liabilities.**
- **Program income.**
- Actual **outlays or expenditures**, with further breakdowns by:

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- The grant program from which the funds are derived.⁴
- The “eligible activity” classifications specified in 24 CFR 570.201–570.206 (housing rehabilitation, economic development, public facilities, public services, etc.) or similar classifications which clearly indicate use of program funds for eligible activities.

Maintenance of Records

The internal control requirements provide for the **separation of duties** and the **secure storage** of accounting records in limited access areas. In maintaining these accounting records a subrecipient should also ensure that:

- Journal entries are properly approved and explained/supported.
- Posting and trial balances are performed regularly.
- Fidelity bond coverage is obtained for responsible officials of the organization.

The grantee may require the subrecipient to purchase additional fidelity bond coverage in cases where it believes the normal policy coverage is not sufficient to protect the interest of the Government.

2.4 Allowable Costs (see 24 CFR 85.22 and 84.27)

The standards for determining the reasonableness, allowability, and allocability of costs incurred as part of CDBG-financed activities are found in **OMB Circular A-87 for governmental subrecipients, OMB Circular A-122 for non-profit subrecipients, and OMB Circular A-21 for educational institutions.**

According to basic guidelines contained within these OMB circulars, a *cost is allowable* under the CDBG program if:

1. The expenditure is *necessary, reasonable, and directly related to the grant.*

This standard applies equally to such items as salaries and administrative services contracts, as well as to real property and equipment purchases or leases, travel, and other administrative expenditures. In determining the reasonableness of a given cost, consideration shall be given to:

⁴ Subrecipients are encouraged, but not required by HUD, to identify expenditures by the specific grant.

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- a) Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the organization or the performance of the award.
 - b) The restraints or requirements imposed by such factors as generally accepted sound business practices, arms length bargaining, Federal and state laws and regulations, and terms and conditions of the award.
 - c) Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its members, employees and clients, the public at large, and the Government.
 - d) Significant deviations from the established practices of the organization that may unjustifiably increase the award costs.
2. The expenditure has been ***authorized by the grantee*** (the city or county that provides the CDBG funds to the subrecipient), generally through approval of the budget for the activity.

For example, grantees generally are limited by HUD to obligating no more than 15 percent of any year's CDBG award on public services expenses. Therefore, in their agreement with a subrecipient, the grantee will stipulate how much the particular subrecipient will be allowed to obligate on such activities to keep the grantee's overall public services expenditures within the 15-percent ceiling. Any obligations by the subrecipient on such activities exceeding the approved amount may be disallowed by the grantee based upon the provisions of the Subrecipient Agreement.

3. The ***expenditure is not prohibited*** under Federal, state, or local laws or regulations.

For example, OMB Circular A-87, Attachment B, and OMB Circular A-122, Attachment B, explicitly prohibit expenditure of Federal funds for entertainment, contributions and donations, fines and penalties, and bad debts.⁵

In addition, the regulations specific to the CDBG program (at 24 CFR 570.207) prohibit the use of program funds for:

⁵ OMB Circulars A-87 and A-122 also prohibit expenditures on interest and other financial costs *except where authorized by legislation* as is the case under Section 105(a)(13) of Title I of the Housing and Community Development Act of 1974, as amended, which specifically identifies "reasonable ... carrying charges related to the planning and execution of community development and housing activities" as eligible costs under the CDBG program.

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- **Buildings used for the general conduct of government**
- **General governmental expenses**
- **Political activities**

This section of the program regulations also specifies that the following activities may *not* be assisted with CDBG funds *unless* authorized as a special economic development activity under 24 CFR 570.203, *or* when carried out by Community-Based Development Organizations (CBDOs) under the provisions of 24 CFR 570.204, or when the other special conditions noted in the following section after each category are met:

- **Purchase of construction equipment** (unless purchased for use as part of a solid waste disposal facility, which is eligible under 24 CFR 570.201(c)).
 - **Personal property, furnishings, fixtures, or motor vehicles** (unless these items constitute part or all of a public services activity under 24 CFR 570.201(e), are eligible as fire fighting equipment under 24 CFR 570.201(c), or are necessary in the administration of activities assisted with CDBG funds).
 - **Operating and maintenance expenses** (except for expenses associated with public service, “In Rem,” and interim assistance activities, or office space for program staff employed in carrying out the CDBG program).
 - **New housing construction** (unless performed in accordance with the “last resort” housing provisions of 24 CFR Part 42, or carried out by a CBDO under Section 570.204).
 - **Income payments** (this prohibition does not preclude payments made under 24 CFR 570.201(n) to facilitate and expand homeownership by low- and moderate-income persons or emergency grant payments made over a period of up to 3 consecutive months to the provider of such items as food, clothing, housing, or utilities).
4. The *expenditure is consistently treated*, in the sense that the subrecipient applies generally accepted accounting standards in computing the cost, and utilizes the same procedures in calculating costs as for its non-Federally assisted activities.

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5. The *cost must be allocable to the CDBG program*. A cost is allocable to a particular cost objective (e.g., grant, program, or activity) in proportion to the relative benefits received by that objective. This means that:
 - If an office is utilized by two programs during the same hours, the costs of the office should be allocated between the two programs on an equitable basis.
 - The same expense cannot be claimed against more than one grant (i.e., double-billing is prohibited). In addition:
 - A cost originally allocable to a particular Federal grant program **cannot be shifted to another Federal grant program** to overcome funding deficiencies, to avoid restrictions imposed by the grant or by law, or for any other reasons.
 - In accordance with the guidance found in OMB Circulars A-87 and A-122, the composition of direct and indirect costs must be clear. **Direct costs** must be identified specifically with a particular activity. **Indirect costs** are those incurred for common objectives that benefit more than one activity (e.g., salaries of executive officers, accounting and auditing, other costs of general administration). The subrecipient's indirect costs must be supported by an indirect cost proposal/cost allocation plan prepared in accordance with U.S. Department of Health and Human Services Circular OASMB-5 (for non-profit subrecipients) or OASC-10 (for governmental subrecipients).
6. The *cost is net of all applicable credits*. Any credits such as purchase discounts or price adjustments must be deducted from total costs charged. The subrecipient is not allowed to make a profit from any costs charged to CDBG funds.

2.5 Source Documentation

The general standard is that *all accounting records must be supported by source documentation (see 24 CFR 85.20(b)(6) and 84.21(b)(7))*. Supporting documentation is necessary to show that the costs charged against CDBG funds were incurred during the effective period of the subrecipient's agreement with the grantee, were actually paid out (or properly accrued), were expended on allowable items, and had been approved by the responsible official(s) in the subrecipient organization.

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The source *documentation must explain the basis of the costs incurred* as well as show the actual dates and amount of expenditures. For example:

- With respect to **payrolls**, source documentation should include employment letters and all authorizations for rates of pay, benefits, and employee withholdings. Such documentation might include union agreements or minutes from board of directors' meetings where salary schedules and benefit packages are established, copies of written personnel policies, W-4 forms, etc. For staff time charged to the CDBG program activity, **time and attendance records should be available**. If an employee's time is split between CDBG and another funding source, there must be time distribution records supporting the allocation of charges among the sources. Canceled checks from the employees, insurance provider, etc., or evidence of direct deposits will document the actual outlay of funds.
- With respect to the cost of **space and utilities**, space costs must be supported by documentation such as rental or lease agreements. Utility costs will be supported by bills from the utility companies. Both types of expenses will be supported by canceled checks. If the cost of space or utilities is split between the CDBG program and other sources, there must be a reasonable method in place to allocate the charges fairly among the sources, consistent with the guidelines covering allocable costs in Section 2.4.
- With respect to **supplies**, documentation would include purchase orders or requisition forms initiated by an authorized representative of the subrecipient, an invoice from the vendor (which has been signed-off by the subrecipient to indicate the goods were received), the canceled check from the vendor demonstrating payment was made, and information regarding where the supplies are being stored and for what cost objective(s) they are being used.

Some additional requirements related to source documentation include:

- All **source documentation** does not have to be located in the CDBG project files, but it must be **readily available for review by the grantee, HUD, or other authorized representatives at all times**. For example, employment letters and salary schedules are not likely to be maintained in a subrecipient's CDBG files but instead will be kept in the organization's central personnel files.
- The subrecipient must ensure that either (a) **an encumbrance/obligation is recorded** whenever a contract is signed or a purchase order is issued or (b) **up-to-date information on the status of all obligations** is otherwise readily accessible.

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- The subrecipient must maintain a complete, accurate, and up-to-date record of the receipt and use of CDBG-generated **program income**. (See Chapter 6.0.)

2.6 Budget Controls

Subrecipients must have procedures in place to monitor obligations and expenditures against their approved budget(s) for CDBG-funded activities. **Depending on the language of the Subrecipient Agreement, the grantee may be under no obligation to reimburse a subrecipient for expenditures that exceed approved budget line items or the overall budget for CDBG-assisted activities.** Therefore, the subrecipient needs to have an ongoing system to compare actual receipts, encumbrances, and expenditures with the CDBG budget to ascertain in a timely fashion **whether it will be necessary to initiate a formal budget revision**. In addition, since the budget reflects the subrecipient's best estimate of the resources necessary to accomplish the CDBG project scope of services, any pattern of line item overruns should prompt a careful re-assessment of whether the available resources will still be sufficient to achieve the agreed-upon objectives.

To compare and control expenditures to approved budgets, a subrecipient must:

- Maintain in its accounting records **the amounts budgeted for eligible activities**.
- **Include unexpended/unobligated balances** for budgeted categories, as well as obligations and expenditures.
- Periodically **compare actual obligations and expenditures to date against planned obligations and expenditures, and against projected accomplishments for such outlays**.

Obviously, these comparisons should be made on an ongoing basis, and not after a majority of funds have been committed. In addition, it is critical that subrecipients maintain a close watch over the progress achieved for the amount of funds expended. It does little good to stay within the budget line if the actual accomplishments lag far behind in terms of the units of service delivered.

2.7 Cash Management

Subrecipients are required to have procedures in place to minimize the time elapsed between receipt of funds from the grantee and the actual disbursement of those funds. This requirement is intended to curtail unnecessary drawdowns of CDBG funds (through the grantee) from the U.S. Treasury and minimize the cost of financing the CDBG program by the Federal Government.

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Grantees have two general methods available to transfer CDBG grant funds to subrecipients: the reimbursement method and the cash advance method.

- The **reimbursement method** entails a transfer of grant funds to the subrecipient **based on actual expenditures by the subrecipient before the request for funds.**
- **The cash advance method** involves the transfer of CDBG funds from the grantee based upon the subrecipient's request (and information on obligations) **before the actual cash disbursements have been made by the subrecipient.**

Both methods must be implemented in compliance with the cash management requirements. In accordance with 24 CFR 85.21 or 570.502(b)(3)(i), as applicable, and 31 CFR Part 205⁶, these requirements include:

- A subrecipient must include *accurate information in its drawdown request to a grantee*. This requirement is intended to address the intentional falsification of drawdown information. The Federal Government is also concerned that all subrecipients have adequate financial record-keeping systems in place to be able to determine reliably how much cash they have on hand and what their immediate cash needs will be.
- *Although there is no explicit regulation for cash advances, the general standard is that the subrecipient must disburse the funds to pay for CDBG program costs within 3 business days of the receipt of those funds from the grantee.* The subrecipient should also maintain written justification in its files for each instance in which disbursement of an advance took longer than a 3-day period.
- A subrecipient must *return erroneously drawn funds to the grantee in a timely fashion*. This applies to both advances and reimbursement payments when it is determined that the transfer resulted in more funds being drawn down than what was required by the subrecipient's immediate disbursement needs.

For example, if a subrecipient drew down CDBG funds in anticipation of the start of a public facilities project, and the project's commencement was delayed, the subrecipient is required to return the CDBG funds to the grantee and re-initiate the drawdown process at a later point.

⁶ These are the regulations of the U.S. Department of the Treasury governing withdrawal of cash from the Treasury for an advance under a Federal grant program.

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- If CDBG *grant advances* are placed in an interest-bearing account by a subrecipient, the subrecipient must ***return this interest income to the U.S. Treasury*** via the grantee (per 24 CFR 85.21(i) or 570.502(b)(3)(i), as applicable, and 24 CFR 570.500(a)(2)). Such interest income is not considered program income. Similarly, if a subrecipient uses a “*revolving loan fund account*” under the CDBG program, ***the funds must be deposited in an interest bearing account, and all interest earned on funds on deposit must be returned to the Treasury via the grantee no less frequently than annually*** (24 CFR 570.500(b)).
- ***Program income (other than program income deposited in a revolving fund) must be disbursed in payment of program costs before requesting further drawdowns from the grantee*** (24 CFR 570.504(b)(2)(ii) and 570.504(c)).
- If program income is put in an approved revolving fund by a subrecipient, the subrecipient must ***disburse this program income for the same activity for which the revolving fund was established***, before making further cash drawdown requests to the grantee for the activity. The account must be interest bearing, and interest earned or funds held in the account must be remitted to the grantee at least annually (24 CFR 570.504(b)(2)(i) and 570.500 (b)).
- Funds held in an ***escrow account*** for rehabilitation activities generally must be disbursed within 10 days (24 CFR 570.511(a)(4)).

While avoiding excessive drawdowns, a subrecipient should also exercise care that the legitimate cash needs of its CDBG activities are being met. As noted in the preceding section, a subrecipient needs to be able to forecast accurately what its project expenses are going to be. If its CDBG activities are relatively stable (the same type and level of activities from month to month), a subrecipient can begin with the previous month’s financial activity as a starting point for its estimate of current period cash needs. This estimate, however, should be modified for periodic expenses or seasonal variations in costs, such as for heating and electricity. If a subrecipient’s activities are expanding or exhibit irregular fluctuations in expenses, then it is important to devote more careful attention to predicting future cash requirements.

It should be noted that, in the private sector, the “cash requirements report” is a standard management tool for anticipating the monthly (or even weekly) cash flow needs of a business. When a subrecipient is not able to plan its expenditures and encounters large fluctuations in the disbursement of obligated funds (as can happen, for example, in construction activities), there is a tendency to invade other non-CDBG funds, or alternatively to “temporarily borrow” CDBG funds for non-CDBG purposes. ***Such inter-fund transfers that result in using CDBG funds for***

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non-CDBG purposes are not allowed and may result in program sanctions or termination of the CDBG contract by the grantee.

2.8 Financial Reporting

Financial reports prepared by a subrecipient must be accurate, timely, current, and represent a complete disclosure of the financial activity and status in each Federal grant program under which assistance is received (24 CFR 85.20(b) and 85.41(c) and (d), or 84.21 and 24 CFR 570.502(b)(3)(i), as applicable).

Although the format and frequency of the financial reports required of subrecipients may differ from locality to locality, a subrecipient must have the capacity to provide at least the following information **for each CDBG activity**:

- *Amount budgeted.*
- *Advances/reimbursements* received to date.
- *Program income and other miscellaneous receipts* in the current period and to date.
- *Actual expenditures/disbursements* in the current period and cumulatively to date, for both program income and regular CDBG grant funds.

