

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 subrecipients¹** 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.

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- *Current encumbrances/obligations* in addition to disbursements.
- *Unpaid requests for payment* previously submitted at time of latest drawdown.

In addition, a subrecipient's accounting and record-keeping system must be able to support the data included in (a) its drawdown requests, (b) its other financial and progress reports, and (c) the grantee's Consolidated Annual Performance and Evaluation Report (CAPER) submitted to HUD.

2.9 Other Miscellaneous Requirements for Subrecipient Financial Management Systems

- **Loan servicing:** A subrecipient must have a system for properly servicing all CDBG-funded loans, where applicable, including:
 - **Loan agreements** with clear repayment terms and default definitions, descriptions of how defaults can be resolved, what actions will be taken if a loan is in default, and what is pledged as security for each loan.
 - **Collection procedures** that provide for recognition of all current amounts due and when past payments were received, notification when payments are overdue, as well as a procedure for taking further action to collect overdue amounts and criteria for writing off bad debts.
- **Cash depositories:** Regular banking procedures may be followed without any separate bank account or special bank eligibility requirements. Subrecipients are advised, however, to obtain information on bank ratings before depositing CDBG funds with a financial institution.⁷

In addition, subrecipients are encouraged to use minority-owned financial institutions in conjunction with their CDBG activities whenever possible.

⁷ Bank rating and research firms which provide information on the comparative financial strength of local banks and other financial institutions are found in most regions of the country. Frequently the local city or county treasurer's office subscribes to a bank rating service and may be able to provide subrecipients with useful information on the ratings of local financial institutions.

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- **Real property:** The subrecipient must:
 - Keep track of CDBG-acquired real property to ensure that program income from sales or rental of such property or assets is properly recorded and reported (24 CFR 570.503(b)(3)).
 - Have procedures for ensuring ongoing compliance with the National Objectives requirements associated with real property acquired or improved with CDBG funds in excess of \$25,000 (24 CFR 570.503(b)(7)).

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Exercise for Chapter 2.0 — Financial Management

Circle the Correct Answer

1. Which of the following are components of an organization's system of *internal controls* for financial management?
 - (a) Written procedures and policies.
 - (b) Specified job responsibilities.
 - (c) Job qualifications.
 - (d) Accounting records.
 - (e) All of the above.

2. The sole purpose of *accounting records* is to provide reliable and up-to-date information on the cash controlled by an organization or agency.

TRUE

FALSE

3. An expenditure by a subrecipient will be considered an *allowable* CDBG expense if it is necessary to carry out an approved activity and is not explicitly prohibited by Federal, state, or local regulations.

TRUE

FALSE

4. *Source documentation* does not have to be located in the CDBG project files.

TRUE

FALSE

5. An effective system of *budget controls* requires a periodic comparison of actual obligations and expenditures to planned obligations and expenditures, and to projected accomplishments for such outlays.

TRUE

FALSE

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6. Interest income from CDBG advances and revolving loan accounts may be retained by the subrecipient as *program income*.

TRUE

FALSE

The answers are on next page.

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Exercise for Chapter 2.0 — Financial Management (continued)

Answers to questions from preceding pages

1. “(e) All of the above.”
2. **FALSE.** The purpose of accounting records is to provide information *not only on cash* but also on *all the assets and liabilities* of an organization, including property, receivables, payables, and other obligations.
3. **FALSE.** The fact that an expenditure is both necessary and not explicitly prohibited by law and program regulations *is only part of the criteria* that must be met for it *to be considered an allowable CDBG expense*. In addition, the expenditure must:
 - Have been authorized by the grantee (through an approved budget or other mechanism).
 - Be reasonable.
 - Have been treated by the subrecipient in a manner consistent with its normal procedures for computing costs.
 - Be allocable to an approved-CDBG cost objective.
 - Be net of all applicable credits.
4. **TRUE.** *Source documentation does not have to be stored in the CDBG project files if it is readily available to be reviewed by the grantee, HUD, or other authorized representatives.* In general, however, subrecipients will find that it is more efficient in the long run to maintain as much project information as possible in files specifically dedicated to their CDBG activities.
5. **TRUE.**
6. **FALSE.** One of the primary purposes of a subrecipient’s *cash management* system is to minimize the time between receipt of CDBG funds and their disbursement; therefore, if the subrecipient’s system is working efficiently, *there shouldn’t be any interest income* generated on cash advances. In fact, 24 CFR 570.500(a)(2) makes explicit that *the definition of program income does not include interest earned on the investment of the initial proceeds of a grant advance, including funds advanced from a grantee to a subrecipient*, and any such funds must be promptly remitted to the U.S. Treasury. Moreover, 570.500(b) makes it clear that cash balances held in a revolving fund must be

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held in an interest-bearing account and that any interest earned on funds held in such an account will be considered to be interest income generated on a cash advance and must be remitted to the Treasury at least annually.

