

CDBG Expenditures

April 21, 1988

MEMORANDUM FOR: Roger E. Massey, Manager
Omaha Office, 7.2S

FROM: Jack R. Stokvis, General Deputy Assistant Secretary for Community Planning and Development

SUBJECT: Davenport, Iowa - CDBG Expenditures

This memorandum is in response to your memorandums of September 15, 1987 and September 18, 1987. According to those memorandums, the City discovered in 1986 that it had inadvertently over-obligated its CDBG program in prior years. To pay the prior costs, it used 1986 grant funds, depleting its entire letter of credit. It then had to use \$400,000 of its General Funds to complete the CDBG program year. The question raised is whether such use of the 1986 grant was an allowable cost, and whether subsequent grants and program income received by the City can be used to reimburse its General Fund.

OMB Circular A-87 prohibits the use of grant funds for costs incurred prior to the effective date of the grant, whether or not they would have been allowed thereunder if incurred after such date unless the costs are specifically provided for in the grant agreement. Attachment B., Section C.6. The CDBG regulations, which are incorporated in the grant agreement, permit certain quite limited pre-agreement costs (presumably generally not relevant here). §570.200(a)(5)

This limitation on pre-agreement costs is generally not an issue in the Entitlement program for activities covered in the final statements corresponding to grants that have been made because HUD's accounting procedures do not track activities to grants. HUD uses the accounting principle of "first in/first out" for recording drawdowns from a grantee's letter of credit, i.e., the "oldest" money in the letter of credit is always disbursed to pay for the costs of an activity regardless of the program year of the final statement in which the activity is listed. Because activities vary in the time needed for implementation and for disbursement of funds (e.g., rehabilitation activities may take considerable time from homeowner application stage to work completion, while public service activities may be a continuation of service with no time lag), it is not uncommon that a grantee would have a current disbursement need for an activity that was in an earlier final statement. Where a grantee has CDBG funds (funds in its letter of credit or program income) and uses the funds for activities listed in previous or current final statements or amendments thereto, the Department presumes that there is no violation of the preagreement costs limitation.

This presumption is not made where a grantee has used all its CDBG funds and has additional costs of uncompleted activities. While HUD does not track activities to grants, nevertheless, each annual grant is made for the activities proposed in the final statement for that year and the total costs of the activities in the final statement should equal the grant (plus anticipated program income) amount. When the total costs to complete all activities in the final statements will exceed the grant (plus anticipated program

income) amounts, the excess costs are preagreement costs if charged to a future grant (or program income not planned for in the final statement). That is the situation here.

In addition, where a grantee has used all its CDBG funds and has additional costs or uncompleted activities, the final statements do not accurately reflect the use of the funds because the grantee clearly does not have sufficient funds to do all the activities that it had proposed to its citizens and to HUD. The only way that the grantee could do all the activities listed in its final statements would be by continually "borrowing" from future grants. In order to have meaningful citizen participation so that citizens understand how the CDBG funds will actually be used, the grantee must choose the old and/or new activities it will undertake (based upon the grant amount and realistically anticipated program income) and indicate that choice in the final statement and by following the required procedure for amending its activities.

The following remedies must be taken to correct the problem and to prevent its recurrence:

1. Davenport must develop and implement financial controls which are determined by HUD to meet the requirements of 24 CFR Part 85.20 to provide effective control and accountability for all CDBG funds, including comparison of CDBG funds with budgeted amounts for CDBG activities.
2. Since Davenport has no pre-1987 CDBG funds left, it must amend its 1987 final statement as follows:
 - a. Add the CDBG activities included in prior final statements for which costs were incurred prior to the 1987 grant (i.e., preagreement costs), which the city proposes to pay with its 1987 grant funds. (The activities to be added would include those paid for from the City's general fund in the amount of \$400,000 if that fund is to be reimbursed from the 1987 grant.) The amendment must explain that the added activities were in prior year final statements and that unpaid costs for the activities are proposed to be paid with the 1987 grant because all pre-1987 CDBG funds have been expended. For each such activity the amendment is to identify the program year of the prior final statement in which it was listed and the 1987 grant amount to be expended. The limitation on preagreement costs in §570.200(a)(4) is hereby waived to permit the 1987 grant to be used for the costs listed in the amendment required under this paragraph. The 1987 grant agreement must be amended to specifically identify such activities.
 - b. List any activities included in prior final statements for which costs have not yet been incurred. The amendment must explain that the activities were in prior year final statements but no pre-1987 CDBG funds remain for financing the activities. For each activity the amendment must show that the activity is either being deleted or to be funded with the 1987 grant. The projected costs and the program year of the final statement in which the activity was originally included is to be shown. (If the activity is to be funded with some future post-1987 grant, the amendment should delete the activity and explain that it is expected to be included in a proposed statement for such future grant).
 - c. Finally the amendment must delete any activities which were listed in the 1987 final statement, but which will not now be funded because the funds are to be used for the pre-1987 activities.

3. Issue a warning letter that continued failure to comply with financial management, preagreement cost and amendment requirements described above may result in a grant condition and possible reduction of its FY 1988 entitlement grant.
4. Request a review by the Regional Inspector General for Audit to (1) evaluate Davenport's CDBG financial management systems and (3) recommend appropriate corrective actions.