

14.228

**COMMUNITY DEVELOPMENT BLOCK GRANTS/STATE'S
PROGRAM AND NON-ENTITLEMENT GRANTS IN HAWAII**
(State-Administered Small Cities Program)

STATE PROJECT/PROGRAM: **NORTH CAROLINA SMALL CITIES CDBG AND
NEIGHBORHOOD STABILIZATION PROGRAM**

FEDERAL AUTHORIZATION: **U. S. Housing and Urban Development**
Title I of the Housing and Community Development Act of 1974, as amended (42 USC 5301); 24 CFR 570; 2301 – 2304 of the Housing and Economic Recovery Act of 2008 (Public Law 110-289 (July 30, 2008)) (HERA); The Notice of Allocations, Application Procedures, Regulatory Waivers Granted to and Alternative Requirements for Redevelopment of Abandoned and Foreclosed Homes Under the Housing and Economic Recovery Act, 2008 published at 73 FR 58330 (October 6, 2008) (Notice); Title XII of the American Recovery and Reinvestment Act of 2009 (ARRA), Pub. L. Nov. 111-5.

STATE AUTHORIZATION: **4 NCAC 19L**

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The auditor should not consider the Supplement to be “safe harbor” for identifying audit procedures to apply in a particular engagement, but the auditor should be prepared to justify departures from the suggested procedures. The auditor can consider the supplement a “safe harbor” for identification of compliance requirements to be tested if the auditor performs reasonable procedures to ensure that the requirements in the Supplement are current. The grantor agency may elect to review audit working papers to determine that audit tests are adequate.

Auditors may request documentation of monitoring visits by the State Agencies.

This compliance supplement should be used in conjunction with the OMB 2019 Compliance Supplement which will be issued in the summer. This includes “Part 3 - Compliance Requirements,” for the types that apply, “Part 6 - Internal Control,” and “Part 4 - Agency Program” requirements if the Agency issued guidance for a specific program. The OMB Compliance Supplement is Section A of the State Compliance Supplement.

I. PROGRAM OBJECTIVES

The primary objective of the Community Development Block Grants (CDBG) /State's Program and Non-Entitlement Grants in Hawaii (State-Administered Small Cities Program) is the development of viable communities by providing decent housing, a suitable living environment, and expanded economic opportunities, principally for persons of low- and moderate-income. This objective can be achieved in two ways. First, funds can only be used to assist eligible activities that fulfill one or more of three national objectives. Second, the grantee must spend at least 70 percent of its funds over a period of up to three years, as specified by the grantee in its certification, for activities that address the national objective of benefiting low- and moderate-income persons (42 USC 5301(c) and 5304(b)(3)).

The Housing and Economic Recovery Act of 2008 (HERA) (Pub. L. No. 110-289, July 30, 2008) provided funds for emergency assistance for redevelopment of abandoned and foreclosed homes and residential properties, and provides under a rule of construction that, unless HERA provides otherwise, the grants are to be considered CDBG funds. The grant program under Title III is referred to as the Neighborhood Stabilization Program (NSP). **The NSP funding covered in this cluster is the funding provided under HERA and is not NSP funding provided under ARRA. These HERA funds are also referred to as NSP1 in the Neighborhood Stabilization Program (see CFDA 14.256, Section II, "Program Procedures").**

II. PROGRAM PROCEDURES

CDBG funds are provided, according to a statutory formula, to those States that elect to administer their CDBG non-entitlement funds. The States, in turn, distribute the funds to small units of general local government (subrecipients) that do not qualify for grants under the CDBG Entitlement Program. The non-entitlement counties in Hawaii are handled differently than Entitlement grantees in the following ways: (1) their funding comes from Section 106(d) of the Housing and Community Development Act of 1974, as amended (42 USC 5306(d)); (2) funds are distributed using the formula contained in 24 CFR section 570.429(c); reallocations due to grant reductions, or funds not applied for, go to the other non-entitlement counties in Hawaii on a pro rata basis (24 CFR section 570.429(d)); (3) non-entitlement counties are not eligible to use the exception criteria in 24 CFR section 570.208(a)(1)(ii); and (4) 24 CFR section 570.307 (Urban Counties) and 24 CFR section 570.308 (Joint Requests) would not apply to non-entitlement counties in Hawaii. Except for these differences, non-entitlement counties in Hawaii should follow the requirements of CDBG Entitlement Grants (CFDA 14.218).

For the CDBG program, in addition to Federal statutory requirements, each State has the authority to issue rules consistent with Federal statutes and regulations. The State rules should be reviewed before beginning the audit (24 CFR sections 570.480 and 570.481).

Except for the requirement to provide public notice of Federal financial assistance programs in 2 CFR section 200.202 and the Subrecipient Monitoring and Management requirements in 2 CFR sections 200.330 through 200.332, the guidance in 2 CFR part 200 (Uniform Guidance), subparts C, D, and E, as implemented by the Federal agency, does not apply to Community Development Block Grant Program (refer to Uniform Guidance §200.101(d)(1), block grant awards authorized by the Omnibus Budget Reconciliation Act of 1981).

The NSP grant is a special CDBG allocation to address the problem of abandoned and foreclosed homes. The HERA established the need, targets the geographic areas, and limits the eligible uses of NSP funds. A State choosing to carry out an activity directly must apply the requirements of 24 CFR section 570.208(a) to determine whether the activity has met the low-, moderate-, and middle-income national objective and must maintain the documentation required at 24 CFR section 570.506 to demonstrate compliance to HUD.

Source of Governing Requirements

These programs are authorized under Title I of the Housing and Community Development Act of 1974, as amended (42 USC 5301) Implementing regulations may be found at 24 CFR part 570, subpart I.

The NSP is authorized by Title III of Division B of HERA. HUD published a “Notice of Allocations, Application Procedures, Regulatory Waivers Granted to and Alternative Requirements for Emergency Assistance for Redevelopment of Abandoned and Foreclosed Homes Grantees Under the Housing and Economic Recovery Act, 2008,” (NSP Notice) that advises the public of the allocation formula, allocation amounts, the list of grantees, alternative requirements, and the waivers of regulations provided to grantees (see October 6, 2008, *Federal Register*, 73 FR 58330-58349).

III. COMPLIANCE REQUIREMENTS

A. Activities Allowed or Disallowed

1. Section 105(a) of the Housing and Community Development Act of 1974 lists the activities eligible under the CDBG State’s Program (State administered small cities program), which include: (a) the acquisition of real property; (b) the acquisition, construction, reconstruction, or installation of public works, facilities and site, or other improvements, including those that promote energy efficiency; (c) code enforcement in deteriorated or deteriorating areas; (d) clearance, demolition, reconstruction, rehabilitation, and removal of buildings and improvements; (e) removal of architectural barriers that restrict accessibility of elderly or severely disabled persons; (f) payments to housing owners for losses of rental income incurred in temporarily holding housing for the relocated; (g) disposition of real property acquired under this program; (h) provision of public services (subject to limitations contained in the CDBG regulations); (I) payment of the non-Federal share for another grant program that is part of the assisted activities; (j) payment to complete a Title 1 Federal Urban Renewal project; (k) relocation assistance; (l) planning activities; (m) administrative costs; (n) acquisition, construction, reconstruction, rehabilitation, or installation of commercial or industrial buildings; (o) assistance to neighborhood-based nonprofit organizations, local development corporations, nonprofit organizations serving the development needs of communities in non-entitlement areas to carry out a neighborhood revitalization or community economic development or energy conservation project; (p) activities related to development of energy use strategies; (q) assistance to private, for-profit businesses, when appropriate to carry out an economic development project; (r) rehabilitation or development of housing assisted under Section 17 of the United States Housing Act of 1937; (s) technical assistance to public or private entities for capacity building (exempt from the planning/administration cap); (t) housing services related to HOME-funded activities; (u) assistance to institutions of higher education to carry out eligible activities; (v) assistance to public and private entities (including for-profits) to assist micro-enterprises; (w) payment for repairs and operating expenses for acquired “in Rem” properties; (x) direct home ownership assistance to facilitate and expand home ownership among persons of low-and moderate-income; (y) lead-based paint hazard evaluation, and removal; and (z) construction or improvement of tornado-safe shelters for residents of manufactured housing and provision of assistance to nonprofit and for-profit entities for such construction or improvement (42 USC 5305; 24 CFR section 570.482(a)).
2. Each activity that the State funds must either benefit low- and moderate-income families; aid in the prevention or elimination of slums or blight; or meet other community development needs having a particular urgency because existing conditions pose a serious and immediate threat to the health or welfare of the community where other financial resources are not

available. The State must retain documentation justifying its certifications (24 CFR sections 570.483 and 570.490).

3. Non-entitlement local government grant recipients (subrecipients) may have loans guaranteed by HUD under Section 108 of the Housing and Community Development Act of 1974. Guaranteed loan funds may be used only for the following activities: (a) acquisition of real property; (b) housing rehabilitation; (c) rehabilitation of publicly owned real property; (d) eligible CDBG economic development activity; (e) relocation payments, (f) clearance, demolition, and removal; (g) payment of interest on Section 108 guaranteed obligations; (h) payment of issuance and other costs associated with private-sector financing under this subpart; (i) site preparation related to redevelopment or use of real property acquired or rehabilitated pursuant to this subpart or for economic development purposes; (j) construction of housing by nonprofit organizations for homeownership under Section 17(d) of the U.S. Housing Act of 1937 (12 USC 1715(l)) or Title VI of the Housing and Community Development Act of 1987; (k) debt service reserve; (l) acquisition, construction, reconstruction, rehabilitation or installation of public works and site or other improvements that serve “colonias” (as defined in Section 916 of the Housing Act of 1990 and amended by Section 810 of the Housing and Community Development Act of 1992); and (m) acquisition, construction, reconstruction, rehabilitation, or installation of public facilities (except for buildings for the general conduct of government), public streets, sidewalks, and other site improvements and public utilities (24 CFR sections 570.700 through 570.710).
4. For NSP fund, HERA requirements have superseded some CDBG requirements to allow for eligible uses in Section 2301(c)(3) of HERA. The NSP categories and CDBG entitlement regulations are listed in Section II.H.3.a of NSP Notice, 73 FR 58338. The NSP eligible uses are to:
 - a. Establish financing mechanisms for purchase and redevelopment of foreclosed upon homes and residential properties.
 - b. Purchase and rehabilitate homes and residential properties that have been abandoned or foreclosed upon for later sale, rent or redevelopment.
 - c. Establish land banks for homes that have been foreclosed upon.
 - d. Demolish blighted structures.
 - e. Redevelop demolished or vacant properties.
5. For NSP funds, NSP requirements supersede existing CDBG requirements (See III.A.1, above) to permit the use of only the low- and moderate-income national objective for NSP-assisted activities. A NSP activity may not qualify using the “prevent or eliminate slums and blight” or “address urgent community development needs” national objectives. The HERA redefines and supersedes the definition of “low- and moderate-income,” effectively allowing households whose incomes exceed 80 percent of area median income but do not exceed 120 percent of median income to qualify as if their incomes did not exceed the published low- and moderate-income levels of the regular CDBG program (Section III.E. of NSP Notice, 73 FR 58335-58336). HUD will refer to this new income group as “middle income” and maintain the regular CDBG definitions of “low-income” and “moderate-income” currently in use (Section 2301(f)(3)(A) of HERA).
6. For purposes of NSP only, an activity may meet the HERA established low- and moderate-income national objective if the assisted activity: (1) provides or improves permanent residential structures that will be occupied by a household whose income is at or below 120 percent of area median income; (2) serves an area in which at least 51 percent of the residents

have incomes at or below 120 percent of area median income; or (3) serves a limited clientele whose incomes are at or below 120 percent of area median income. (Section 2301(f)(3)(A) of HERA; Section II.E. of NSP Notice, 73 FR 58335-58336).

7. Eligible uses of NSP funds authorized by HERA are: (a) establishing financing mechanisms for purchase and redevelopment of foreclosed homes and residential properties; (b) purchasing and rehabilitating homes and residential properties abandoned or foreclosed; (c) establishing land banks for foreclosed homes; (d) demolishing blighted structures; and (e) redeveloping demolished or vacant properties. The NSP Notice lists the CDBG-eligible activities HUD has determined best correlate to these specific NSP-eligible uses. Grantees must receive written HUD approval to undertake activities other than those listed in Section II.H, Eligibility and Allowable Costs, of the NSP Notice (Section 2301(c)(3) of HERA; Section II.H. of NSP Notice, 73 FR 58337-58338).

Audit Objective

1. Determine whether Federal awards were expended only for allowable activities.

Suggested Audit Procedures

1. Identify the types of activities which are either specifically allowed or prohibited by the laws, regulations, and the provisions of contract or grant agreements pertaining to the program.
2. When allow ability is determined based upon summary level data, perform procedures to verify that:
 - a. Activities were allowable.
 - b. Individual transactions were properly classified and accumulated into the activity total.
3. When allow ability is determined based upon individual transactions, select a sample of transactions and perform procedures to verify that the transaction was for an allowable activity.
4. The auditor should be alert for large transfers of funds from program accounts which may have been used to fund unallowable activities.

B. Allowable Costs/Cost Principles

Grantee shall comply with the Uniform Guidance, which is incorporated in these rules and reference including subsequent amendments and editions. (See Program Regulations 4 NCAC 19L Financial Management Systems .0906 (13)).

Audit Objective

1. Determine whether the governmental unit complied with the provisions of the Uniform Guidance as follows:
 - a. Direct charges to Federal awards were for allowable costs.
 - b. Charges to cost pools allocated to Federal awards through the central service CAPs were for allowable costs.
 - c. The methods of allocating the costs are in accordance with the applicable cost principles, and produce an equitable and consistent distribution of costs, which benefit from the central service costs being allocated (e.g., cost allocation bases include all activities, including all State departments and agencies and, if appropriate, non-State organizations which receive services).

- d. Indirect cost rates were applied in accordance with approved indirect cost rate agreements (ICRA), or special award provisions or limitations, if different from those stated in negotiated rate agreements.
- e. For local departments or agencies that do not have to submit an ICRP to the cognizant Federal agency, indirect cost rates were applied in accordance with the ICRP maintained on file.

Suggested Audit Procedures

- 1. Consider the results of the testing of internal control in assessing the risk of noncompliance. Use this as the basis for determining the nature, timing, and extent (e.g., number of transactions to be selected) of substantive tests of compliance. If the local department or agency is not required to submit an ICRP and related supporting documentation, the auditor should consider the risk of the reduced level of oversight in designing the nature, timing, and extent of compliance testing.
- 2. *General Audit Procedures (Direct and Indirect Costs)* – The following procedures apply to direct charges to Federal awards as well as charges to cost pools that are allocated wholly or partially to Federal awards or used in formulating indirect cost rates used for recovering indirect costs from Federal awards.
 - a. Test a sample of transactions for conformance with:
 - (1) The criteria contained in the Uniform Guidance
 - (2) The principles to establish allow ability or unmalleability of certain items of cost (Uniform Guidance).
 - (3) If the auditor identifies unallowable costs, the auditor should be aware that directly associated costs might have been charged. Directly associated costs are costs incurred solely as a result of incurring another cost, and would have not been incurred if the other cost had not been incurred. When an unallowable cost is incurred, directly associated costs are also unallowable. For example, occupancy costs related to unallowable general costs of government are also unallowable.

C. Cash Management

The grantee Financial Management System shall provide for accurate, current and complete disclosure of the financial results of each grant program in accordance with fiscal control and reporting requirements set forth in G.S. 159, Article III the local Government Budget and Fiscal Control Act. Grantees shall meet the following requirements: All grant funds shall be expended in accordance with a project ordinance or budget ordinance adopted under G.S. 159-8 and G.S. 159 - 13.2. Grantee may deposit or invest all or part of the cash balance of any grant fund; however, all interest earned shall be returned to the Rural Economic Development Division – State CDBG. The grantee must designate a bank for its official depositories in order for CI to deposit funds electronically. All CDBG, and NSP funds must be disbursed by the grantee within three (3) banking days upon receipt of the funds. All budgetary accounting for appropriations of grant funds shall be in accordance with the procedures for incurring obligations and disbursement as set forth in G.S. 159-28. Each grantee must establish an accounting system in accordance with G.S. 159-26. Grantee finance officer and each officer, employee, or agent who handles or has in his custody more than one hundred dollars of grant funds at any one time, or who handles or has access to the recipient's inventories, shall be bonded in accordance with G.S. 159-29. Grantee shall maintain records that identify adequately the source and application of funds for grant supported activities. These records shall contain information pertaining to federal awards and authorizations, obligations, unobligated balances assets, liabilities, outlays and income. Grantee cash receipts must be deposited with, or to the credit of, the finance officer. This includes program revenues, reimbursements for travel, vendor payments or previously recorded as

expenditures, and all other grant monies from Rural Economic Development Division – State CDBG. Grantee must develop a systematic method to assure timely and appropriate resolution of audit findings and recommendations. Grantee investment deposits shall be secured as provided in G.S. 159-31 (b). A system for procedures for procurement and property management shall be provided in accordance with Rule .0908 and Rule .0909 of this Section. Recipients shall require subgrantees to adopt the standards set forth in this Rule. Grantees shall comply with the Uniform Guidance, entitled Cost Principles for State and Local Governments. In applying the Uniform Guidance, the term “federal agency” shall mean the Department. Recipients shall record the receipt and expenditure of project revenues from taxes, special assessments, levies, fines, etc., in accordance with GAAP. Subrecipients shall comply with the Uniform Guidance which is incorporated in these Rules by reference including subsequent amendments and editions. (See Program Regulations 4 NCAC 19L .0906).

Audit Objective

1. Determine whether for advance payments the recipient/procedures to minimize the time elapsing between the transfer of funds from the U.S. Treasury, or pass-through entity, and their disbursement.

Suggested Audit Procedures

1. Verify daily cash balance to determine if subgrantee had excess cash on hand.
2. Verify the project authorization matches the budget or project ordinance.
3. Verify whether the grantee followed procedures to disburse funds within 3 banking days within receipt of funds.
4. Verify the employee(s) or agency that handles \$100 or more in grant funds are bonded
5. Determine whether States have complied with the terms and conditions of the Treasury-State Agreement or Subpart B procedures prescribed by Treasury.
6. Select a sample of Federal cash draws and verify that:
 - a. To the extent available, program income, rebates, refunds, and other income and receipts were disbursed before requesting additional Federal cash draws as required.

D. Reserved

E. Eligibility

The local unit of government should have a survey form and income documentation on file to verify eligibility of CDBG recipients (See 24 CFR 570.483). Low-moderate income (LMI) data is located on HUD Website (www.huduser.org/datasets/il.html) by county. Also, a copy of income data may be requested from Rural Division, 4346 Mail Service Center, Raleigh, North Carolina 27699-4346.

Audit Objectives

1. Determine whether required eligibility determinations were made, (including obtaining any required documentation/verifications), that individual program participants or groups of participants (including area of service delivery) were determined to be eligible, and that only eligible individuals or groups of individuals participated in the program.
2. Determine whether subawards were made only to eligible subrecipients.
3. Determine whether amounts provided to or on behalf of eligible participants were calculated in accordance with program requirements.

Suggested Audit Procedure

1. Verify income documentation to ensure the recipient(s) served meets the criteria for low-moderate income.

F. Equipment and Real Property Management

In accordance with Program Regulations 4 NCAC 19L Property Management Standards .0909 3(b) (i) and 3 (b) (ii), grantees must account for the use and disposition of all property acquired with CDBG funds. Nonexpendable personal property with a unit acquisition cost of less than one thousand dollars (\$1,000) may be retained by the grantee for other programs or sold by the grantee without reimbursement to the program budget. Nonexpendable personal property with a unit acquisition cost of one thousand dollars (\$1,000) or more may be retained by the grantee for other uses provided that compensation is made as program income.

Audit Objectives

1. Determine whether the non-Federal entity maintains proper records for equipment and adequately safeguards and maintains equipment.
2. Determine whether disposition or encumbrance of any equipment or real property acquired under Federal awards is in accordance with Federal requirements and that the awarding agency was compensated for its share of any property sold or converted to non-Federal use.

Suggested Audit Procedures

1. Test purchases of equipment of \$1,000.00 value or more to determine if they were bought with CDBG funds. If CDBG funds were used, determine if use of equipment benefited the program.
2. Test all sales of surplus property to determine if any items were purchased with CDBG funds. If so, trace income generated from sale to assure that receipts were treated as program income for the CDBG program.
3. Obtain entity's policies and procedures for equipment management and ascertain if they comply with the State's policies and procedures.
4. Select a sample of equipment transactions and test for compliance with the State's policies and procedures for management and disposition of equipment.
5. *Disposition of Real Property*
 - a. Determine real property dispositions for the audit period and ascertain such real property acquired with Federal awards.
 - b. For dispositions of real property acquired under Federal awards, perform procedures to verify that the non-Federal entity followed the instructions of the awarding agency, which will normally require reimbursement to the awarding agency for the Federal portion of net sales or fair market value at the time of disposition, as applicable.

G. Matching, Level of Effort, Earmarking

1. Matching

States are required to match the funds used for State administrative costs beyond the first \$100,000 on a one-to-one basis, as further described under III.G.3.b, "Matching Level of Effort, Earmarking – Earmarking" (24 CFR section 570.489(a)(1)). This requirement does not apply to NSP funds (Section 2301(e)(2) of HERA; see Section II.N. of NSP Notice, 73 FR 58337).

2. Level of Effort – Not Applicable

3. Earmarking

a. The Housing and Community Development Act of 1974 requires the State to certify that the aggregate use of the CDBG funds it receives, over a period specified by the State not to exceed three years, shall principally benefit low- and moderate-income persons. This requirement means that not less than 70 percent of the funds must be used in this manner (24 CFR section 570.484 and 42 USC 5304(b)(3)).

This requirement does not apply to NSP funds as HERA provides for supersession of the overall 70 percent requirement and establishes an alternative requirement for NSP funds where 100 percent of NSP funds must be used to benefit individuals and households whose income does not exceed 120 percent of the area median income. For NSP, such households are referred to as low-income, moderate-income and middle-income (Section 2301(c)(2) of HERA; Section II.E. of NSP Notice, 73 FR 58336).

b. The State may use up to \$100,000 of its grant funds for administrative purposes. In addition to this amount, up to three percent of the grant may be expended at the State level for administrative costs, provided such funds are matched from State resources on a one-to-one basis. Further, States may use three percent of program income collected, regardless of whether at the State or local government level, for administrative costs. All administrative funds, including the State matching funds, which may be in-kind contributions, must be used to carry out the State's responsibilities. The State may use up to three percent of its grant funds to provide technical assistance to local governments and nonprofit program recipients. The State may use no more than the aggregate of three percent of its grant funds for administrative purposes or technical assistance (24 CFR section 570.489(a)(1) and 42 USC 5306(d)).

c. For planning and administrative costs **under the CDBG program**, the combined expenditures of the State and units of general local governments may not exceed 20 percent of the State's total allocation plus 20 percent of any program income for any given year. Within this Statewide limit, a State may fund grants to local governments consisting entirely of planning activities (24 CFR section 570.489(a)(3)). HERA provides for supersession of the 20 percent of any grant amount plus program income limitation to be used for general administration and planning costs. The alternative requirements are that up to 10 percent of the amount of a NSP grant provided to a grantee and up to 10 percent of program income earned may be used for general administration and planning activities, as those are defined in 24 CFR sections 570.205 and 570.206. For States, the 10 percent includes expenditures by the State, as well as any unit of general local government that the State funds (Section 2301(f)(1) of HERA; Section II.H. of NSP Notice, 73 FR 58337).

d. **For the CDBG program**, the amount of CDBG funds used for public services must not exceed 15 percent of the grant amount received for that year plus 15 percent of the program income attributed to the year. The 15 percent public-services cap applies to each year's allocation of non-entitlement funds for the State. Individual grants to units of general local government are not subject to the public-services cap. Within this Statewide cap, a State may fund grants to local governments consisting entirely of public service activities (42 USC 5305(a)(8)).

e. Under Section 916 of the National Affordable Housing Act of 1990 (NAHA) (Pub L. No. 101-625; 42 USC 5306 note), the States of Arizona, California, New Mexico, and Texas are required to set aside a portion of their State CDBG funds for use in colonias. The Secretary of HUD annually determines the percentage of each state's allocation (up to 10 percent) required to be set aside for this purpose. Entitlement communities in metropolitan areas of less than one million in population are eligible to receive CDBG funding from the colonias set aside in these States (42 USC 5306 note).

- f. At least 25 percent of NSP funds shall be used for the purchase and redevelopment of abandoned or foreclosed upon homes or residential properties that will be used to house individuals or families whose incomes do not exceed 50 percent of the area median income (Section 2301(f)(3)(A)(ii) of HERA).

Audit Objectives

1. *Matching* – Determine whether the minimum amount or percentage of contributions or matching funds was provided.
2. *Earmarking* – Determine whether minimum or maximum limits for specified purposes or types of participants were met.

Suggested Audit Procedures

1. Test to ensure at least 51% of the CDBG funds benefited low-moderate income persons or meet a national objective as specified in HUD regulations.
2. Test to ensure that no more than 17% of the total grant funds are used for administration (based on applicable grant guidelines). For NSP test that no more than 5% funds are used for administration.
3. **Matching**
 - a. Perform tests to verify that the required matching contributions were met.
 - b. Ascertain the sources of matching contributions and perform tests to verify that they were from an allowable source.
 - c. Test records to corroborate that the values placed on in-kind contributions (including third party in-kind contributions) are in accordance with the Uniform Guidance, program regulations, and the terms of the award.
 - d. Test transactions used to match for compliance with the allowable costs/cost principles requirement. This test may be performed in conjunction with the testing of the requirements related to allowable costs/cost principles.
4. **Earmarking**
 - a. Identify the applicable percentage or dollar requirements for earmarking.
 - b. Perform procedures to verify that the amounts recorded in the financial records met the requirements (e.g., when a minimum amount is required to be spent for a specified type of service, perform procedures to verify that the financial records show that at least the minimum amount for this type of service was charged to the program; or, when the amount spent on a specified type of service may not exceed a maximum amount, perform procedures to verify that the financial records show no more than this maximum amount for the specified type of service was charged to the program).
 - c. When earmarking requirements specify a minimum percentage or amount, select a sample of transactions supporting the specified amount or percentage and perform tests to verify proper classification to meet the minimum percentage or amount.
 - d. When the earmarking requirements specify a maximum percentage or amount, review the financial records to identify transactions for the specified activity which were improperly classified in another account (e.g., if only 10 percent may be spent for administrative costs, review accounts for other than administrative costs to identify administrative costs which were improperly classified elsewhere and cause the maximum percentage or amount to be exceeded).

- e. When earmarking requirements prescribe the minimum number or percentage of specified types of participants that can be served, select a sample of participants that are counted toward meeting the minimum requirement and perform tests to verify that they were properly classified.
- f. When earmarking requirements prescribe the maximum number or percentage of specified types of participants that can be served, select a sample of other participants and perform tests to verify that they were not of the specified type.

Level of Effort – *N/A*

H. Period of Availability of Federal Funds

Neither CDBG nor non-CDBG funds involved in a project may be obligated, nor may any conditioned project activities begin until the State CDBG Program releases in writing any and all applicable conditions on the project and the Request for Release of funds has been released in writing. The conditions included in the grantee's funding approval are federal compliance regulations. In certain circumstances, special conditions may be imposed by State CDBG Program. The grantee must submit documentation to State CDBG Program to release all conditions on the funding approval and documentation to release funds, prior to expending funds, except for administration funds. Grantees may incur cost prior to release of conditions and release of funds with prior State CDBG Program approval in accordance with CDBG procurement standards (4NCAC 19L.0908). The local units of government have thirty (30) months from the date the Acting Director of the State CDBG Program signs the grant agreement to complete all grant activities unless otherwise specified in the Grant Agreement. Within ninety (90) days from the date of the Director signature, the local unit of government must release all conditions on the grant's funding approval to expend funds. If all conditions are not released prior to the end of the ninety (90) days period, funds will be de-obligated from the local unit of government unless an extension has been granted by State CDBG Program to extend the release of conditions period.

For most program categories, the local unit of government has twenty-seven (27) months in addition to the first three (3) months, totaling (30) months to complete all activities in the application unless otherwise specified in the Grant Agreement. All grant time frames can be found in the grant agreement which the local unit of government has a copy on file for review.

Audit Objective

1. Determine whether Federal funds were obligated within the period.

Suggested Audit Procedures

1. Review the award documents and regulations pertaining to the program and determine any award-specific requirements related to the grant.
2. Test transactions charged to the Federal award after the end of the period of award availability to verify that the
 - a. obligations occurred within the period. and
3. Test transactions that were recorded during the period of and verify that the underlying obligations occurred within the period.
4. Test adjustments (i.e., manual journal entries) to the Federal funds and verify that these adjustments were for transactions that occurred during the period.

I. Procurement and Suspension and Debarment

Since the CDBG is subject to the Omnibus Budget and Reconciliation Act (OBRA) of 1981, it is exempt to specific portions of the Uniform Guidance requirements found in 2 CFR Part 200, including the procurement requirements. However, it is subject to NC procurement law. Please

refer to the North Carolina Agency Purchasing Manual accessible at: NC Agency Purchasing Manual at:

http://www.pandc.nc.gov/documents/Procurement_Manual_5_8_2013_interactive.pdf.

Grantees shall comply with the procurement standards established in the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (24 CFT 2400) and HUD implementing regulations contained in 24CFR570.489(g). These explicitly prohibit cost plus a percentage of cost and percentage of cost methods of contracting.

HUD regulations at 24 CFR570(h) prohibit conflict of interests, including subsequent amendments and editions. (See Program Regulations 4 NCAC 19L Procurement Standards. 0908 and conflict of interest. 0914) Grantee must have a system of procedures for procurement in accordance with Rule .0908 and Rule .0909 of the Financial Management Systems section of Program Regulations 4 NCAC. 19 L. Grantees Shall Verify contractor eligibility when Davis Bacon requirements are applicable in accordance with the List of parties Excluded from Federal Procurement and Non-Procurement Programs as issued by U.S. General Services Administration

Suggested Audit Procedure

Test to ensure grantee follows procurement standards as established in 24 CFR. Part 2400, 24 CFR 570.489(g) and 24 CFR 570.489(h).

Verify with the U. S. General Services Administration that the contractor is not on the List of Parties who has been excluded from federal procurement and non-procurement programs.

J. Program Income

1. For CDBG, program income does not include income received in a single program year by a unit of general local government and its subrecipients if the total amount of such income does not exceed \$25,000 (24 CFR section 570.489(e)(2)(i))
2. NSP revenue received by a unit of general local government or subrecipient that is directly generated from the use of CDBG funds (which include NSP grant funds) constitutes CDBG program income. The CDBG definition of program income shall be applied to amounts received by units of local government and subrecipients (24 CFR section 570.500; Section II.N. of NSP Notice, 73 FR 58340-58341). However, HERA imposes limitations and requirements that necessitate an alternative requirement to govern the use of program income generated by NSP activities. The limitations and requirements are based on the NSP activity that generated the program income and on the date the income is received (Section 2301(d)(4) of HERA).
 - a. Any revenue from the sale, rental, redevelopment, rehabilitation or any other eligible use of NSP funds is to be provided to and used by the unit of local general government. This provision includes revenue received by a private individual or other entity that is not a subrecipient (Section 2301(d)(4) of HERA; Section II.N. of NSP Notice, 73 FR 58340-58341).
 - b. Program income generated by NSP activities carried out pursuant to Sections 2301(c)(3) of HERA may be retained by the unit of local government if it is treated as additional CDBG funds and used in accordance with the requirements of Section 2301 (Sections 2301(c)(3) of HERA; Section II.N. of NSP Notice, 73 FR 58340-58341).

Audit Objective

1. Determine whether program income is correctly determined, recorded, and used in accordance with the program requirements, Uniform Guidance, as applicable.

Suggested Audit Procedures

1. *Identify Program Income*

- a. Review the laws, regulations, and the provisions of contract or grant agreements applicable to the program and ascertain if program income was anticipated. If so, ascertain the requirements for determining or assessing the amount of program income (e.g., a scale for determining user fees, prohibition of assessing fees against certain groups of individuals, etc.), and the requirements for recording and using program income.
 - b. Inquire of management and review accounting records to ascertain if program income was received.
2. *Determining or Assessing Program Income* – Perform tests to verify that program income was properly determined or calculated in accordance with stated criteria, and that program income was only collected from allowable sources.
3. *Recording of Program Income* – Perform tests to verify that all program income was properly recorded in the accounting records.
4. *Use of Program Income* – Perform tests to ascertain if program income was used in accordance with the program requirements, Uniform Guidance

K. Reserved

L. Reporting

1. Financial Reporting

- a. SF-269, *Financial Status Report* – Not Applicable
- b. SF-270, *Request for Advance or Reimbursement* – Not Applicable
- c. SF-271, *Outlay Report and Request for Reimbursement for Construction Programs* – Not Applicable
- d. SF-272, *Federal Cash Transactions Report* – Not Applicable
- e. SF-425, *Federal Financial Report* – Not Applicable
- f. *Performance and Evaluation Report (OMB No. 2506-0085)* – This report is due from each CDBG grantee within 90 days after the close of its program year in a format suggested by HUD. HUD encourages the submission of the report in both paper and computerized formats. Among other factors, the report is to include a description of the use of funds during the program year and an assessment of the grantee's use for the priorities and objectives identified in its plan. The auditor is only expected to test the financial data in this report (24 CFR sections 91.520 (a) and (c)).

2. Performance Reporting

HUD 60002, *Section 3 Summary Report, Economic Opportunities for Low- and Very Low-Income Persons*, (OMB No. 2529-0043) – For each grant over \$200,000 that involves housing rehabilitation, housing construction, or other public construction, the prime recipient must submit Form HUD 60002 (24 CFR sections 135.3(a), 135.90, and 570.487(d)).

Key Line Items –

- a. 3. Dollar Amount of Award
- b. 8. Program Code
- c. Part I, Column C – Total Number of New Hires that are Sec. 3 Residents
- d. Part II, Contracts Awarded, 1. Construction Contracts

- (1)A. Total dollar amount of construction contracts awarded on the project
- (2)B. Total dollar amount of construction contracts awarded to Section 3 businesses
- (3)D. Total number of Section 3 businesses receiving construction contracts
- e. Part II, Contracts Awarded, 2. Non-Construction Contracts
 - (1)A. Total dollar amount of all non-construction contracts awarded on the project/activity
 - (2)B. Total dollar amount of non-construction contracts awarded to Section 3 businesses
 - (3)D. Total number of Section 3 businesses receiving non-construction contracts

3. Special Reporting – Not Applicable

Audit Objective

1. Determine whether required reports for Federal awards include all activity of the reporting period, are supported by applicable accounting or performance records, and are fairly presented in accordance with governing requirements.

Suggested Audit Procedures

- 1. a. Performance and special reports
 - (1) Trace the reported data to records that accumulate and summarize data.
 - (2) Perform tests of the underlying data to verify that the data were accumulated and summarized in accordance with the required or stated criteria and methodology, including the accuracy and completeness of the reports.
- b. When intervening computations or calculations are required between the records and the reports, trace reported data elements to supporting worksheets or other documentation that link reports to the data.
- c. Test mathematical accuracy of reports and supporting worksheets.
- 2. Test the selected reports for accuracy and completeness.
 - a. For performance and special reports, review the supporting records and ascertain if all applicable data elements were included in the sampled reports.
 - b. For each type of report—
 - (1) When intervening computations or calculations are required between the records and the reports, trace reported data elements to supporting worksheets or other documentation that link reports to the data.
 - (2) Test mathematical accuracy of reports and supporting worksheets.

M. Subrecipient Monitoring

The Uniform Guidance states that subrecipients should be monitored to provide reasonable assurance that the subrecipient administers federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements.

Audit Objectives

- 1. Determine whether the pass-through entity properly identified Federal award information and compliance requirements to the subrecipient, and approved only allowable activities in the award documents.

2. Determine whether the pass-through entity monitored subrecipient activities to provide reasonable assurance that the subrecipient administers Federal awards in compliance with Federal requirements.
3. Determine whether the pass-through entity ensured required audits are performed, issued a management decision on audit findings within 6 months after receipt of the subrecipient's audit report, and ensures that the subrecipient takes timely and appropriate corrective action on all audit findings.
4. Determine whether in cases of continued inability or unwillingness of a subrecipient to have the required audits, the pass-through entity took appropriate action using sanctions.
5. Determine whether the pass-through entity evaluates the impact of subrecipient activities on the pass-through entity.
6. Determine whether the pass-through entity identified in the Schedule of Expenditures of Federal Awards (SEFA) the total amount provided to subrecipients from each Federal program.
7. If for-profit subawards are material, determine the adequacy of the pass-through entity's monitoring procedures for those subawards.

Suggested Audit Procedures

(Note: The auditor may consider coordinating the tests related to subrecipients performed as part of Cash Management (tests of cash reporting submitted by subrecipients), Eligibility (tests that subawards were made only to eligible subrecipients), and Procurement (tests of ensuring that a subrecipient is not suspended or debarred) with the testing of Subrecipient Monitoring.)

1. Gain an understanding of the pass-through entity's subrecipient procedures through a review of the pass-through entity's subrecipient monitoring policies and procedures (e.g., annual monitoring plan) and discussions with staff. This should include an understanding of the scope, frequency, and timeliness of monitoring activities and the number, size, and complexity of awards to subrecipients, including, as applicable, subawards to for-profit entities.
2. **Test the pass-through entity's subaward review and approval documents to determine whether, before award, the pass-through entity checked CCR to determine whether subrecipients were registered.**
3. Test award documents and agreements to ascertain if: (a) at the time of award the pass-through entity made subrecipients aware of the award information (i.e., CFDA title and number; award name and number; if the award is research and development; and name of Federal awarding agency) and requirements imposed by laws, regulations, and the provisions of contract or grant agreements; and (b) the activities approved in the award documents were allowable.
4. Review the pass-through entity's documentation of during-the-award monitoring to ascertain if the pass-through entity's monitoring provided reasonable assurance that subrecipients used Federal awards for authorized purposes, complied with laws, regulations, and the provisions of contracts and grant agreements, and achieved performance goals.
5. Review the pass-through entity's follow-up to ensure corrective action on deficiencies noted in during-the-award monitoring.
6. Verify that the pass-through entity:
 - a. Ensured that the required subrecipient audits were completed. For subrecipients that are not required to submit a copy of the reporting package to a pass-through entity because there were —no audit findings‖ (i.e., because the schedule of findings and questioned costs did not disclose audit findings relating to the Federal awards that the pass-through entity provided and the summary schedule of prior audit findings did not report the status of audit findings

relating to Federal awards that the pass-through entity provided, as prescribed in Uniform Guidance, the pass-through entity may use the information in the Federal Audit Clearinghouse (FAC) database (available on the Internet at <http://harvester.census.gov/sac>) as evidence to verify that the subrecipient had —no audit findings and that the required audit was performed. This FAC verification would be in lieu of reviewing submissions by the subrecipient to the pass-through entity when there are no audit findings.

- b. Issued management decisions on audit findings within 6 months after receipt of the subrecipient's audit report.
 - c. Ensured that subrecipients took appropriate and timely corrective action on all audit findings.
- 7. Verify that in cases of continued inability or unwillingness of a subrecipient to have the required audits, the pass-through entity took appropriate action using sanctions.
 - 8. Verify that the effects of subrecipient noncompliance are properly reflected in the pass-through entity's records.
 - 9. Verify that the pass-through entity monitored the activities of subrecipients not subject to Uniform Guidance, including for-profit entities, using techniques such as those discussed in the —Compliance Requirements provisions of this section with the exception that these subrecipients are not required to have audits under Uniform Guidance.
 - 10. Determine if the pass-through entity has procedures that allow it to identify the total amount provided to subrecipients from each Federal program.

N. Special Tests and Provisions

Environmental Oversight

The State must assume the environmental oversight responsibilities and functions of HUD under Section 104(g), Housing and Community Development (HCD) Act, (42 USC 5304(g)). The State must: (a) require each of its general local governments (subrecipients) to perform as a responsible Federal official in carrying out all HUD environmental review requirements under 24 CFR part 58, National Environmental Policy Act (NEPA), and other applicable authorities; (b) review and approve each subrecipient's Request for Release of Funds (RROF) in accordance with the procedures provided under 24 CFR part 58 subpart H; (c) ensure that each subrecipient observes the statutory requirement that funds cannot be expended or obligated before the State approves its RROF and environmental certification, except as otherwise provided specifically in regulation or authorized by law; and (d) monitor and provide technical assistance to its subrecipients to ensure compliance with the environmental authorities (24 CFR part 58) and the adequacy of environmental reviews.

Audit Objective

- 1. Determine whether the State carries out its environmental oversight responsibilities and functions.

Suggested Audit Procedures

- 1. Examine the State's program for monitoring and enforcing compliance with the environmental authorities.
- 2. Examine the State's approval of the RROF and environmental certification, and note dates.
- 3. Verify that the State obtained certifications and that the State's records provide evidence that the funds were obligated and expended after the State's approval of the RROF and environmental certification.

Environmental Reviews

Projects must have an environmental review unless they meet criteria specified in the regulations that would exclude them from RROF and environmental certification requirements. States that directly implement NSP activities are considered recipients and must assume environmental review responsibilities for the State's activities and those of any non-governmental entity that participates in the project. States that directly implement activities must submit the Request for Release of Funds (RROF) and the certifications to HUD for approval (24 CFR sections 58.4(b)(1), 58.34 and 58.35).

Audit Objective

1. Determine whether the required environmental reviews were conducted and required HUD approvals were obtained.

Suggested Audit Procedures

1. Verify that the State obtained environmental review certifications from the subrecipient and that the State records provide evidence that the environmental reviews were made.
2. For any project where an environmental review was not performed, ascertain that a written determination was made that the review was not required.
3. Ascertain that documentation exists that any determination not to make an environmental review was made consistent with the criteria contained in 24 CFR sections 58.34 and 58.35.
4. Verify that States obtained HUD approvals of RROFs and environmental certifications for State activities.
5. Verify that, for State activities, funds were obligated and expended after HUD approval of State RROFs and environmental certifications.

Citizen Participation

CDBG – Prior to the submission to HUD for its annual grant, the grantee must certify to HUD that it has met the citizen participation requirements in 24 CFR sections 91.115 and 570.486, as applicable.

HERA provided for supersession of the citizen participation requirement to expedite the distribution of NSP grant funds and to provide for expedited citizen participation. The provisions of 24 CFR sections 570.485 and 570.486 with respect to following the citizen participation plan are waived to allow the jurisdiction to provide no fewer than 15 calendar days for citizen comment, rather than 30 days, for its initial NSP submission (Section II.B.4 of NSP Notice, 73 FR 58334).

Audit Objective – CDBG

1. Determine whether the CDBG grantee has developed and implemented a citizen participation plan.

Suggested Audit Procedures – CDBG

1. Verify that the grantee has a citizen participation plan.
2. Review the plan to verify that it provides for public hearings, publication, public comment, access to records, and consideration of comments.
3. Examine the grantee's records for evidence that the elements of the citizen's participation plan were followed as the grantee certified.

Rehabilitation Using NSP Funds

Any NSP-assisted rehabilitation of a foreclosed-upon home or residential property shall be completed to the extent necessary to comply with applicable laws, codes and other requirements relating to housing safety, quality, or habitability, in order to sell, rent or redevelopment such homes and properties. To comply with this provision, a grantee must describe or reference in its NSP action plan amendment what rehabilitation standards it will apply for NSP-assisted rehabilitation (Section 2301(d)(2) of HERA; Section II.I. of NSP Notice, 73 FR 58338).

Audit Objective

1. To determine whether the grantee assures NSP rehabilitation work is properly completed.

Suggested Audit Procedures

1. Review rehabilitation standards established for NSP work.
2. Verify through a review of documentation that the rehabilitation work is inspected upon completion to ensure that it is carried out in accordance with applicable rehabilitation standards.

Davis-Bacon Act

The requirements of the Davis-Bacon Act apply to the rehabilitation of residential property only if such property contains eight or more units. However, the requirements do not apply to volunteer work where the volunteer does not receive compensation, or is paid expenses, reasonable benefits, or a nominal fee for such services, and is not otherwise employed at any time in construction work

Audit Objective

1. Determine whether the non-Federal entity notified contractors and subcontractors of the requirements to comply with the Davis-Bacon Act and obtained copies of certified payrolls.

Suggested Audit Procedure

1. Select a sample of construction contracts and subcontracts greater than \$2000 that are covered by the Davis-Bacon Act and perform the following procedures:
 - a. Verify that the required prevailing wage rate clauses were included.
 - b. Verify that the contractor or subcontractor submitted weekly the required certified payrolls.

(Note: Auditors are not expected to determine whether prevailing wage rates were paid.)

Real Property Acquisition and Relocation Assistance

Grantees shall follow the requirements of the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 (URA), Sections 104(d) and 106(d)(5)(A) of Title I of the Housing and Community Development Act of 1974 (the Act), as amended, and HUD Implementing regulations, 24 CFR 570.488 and 570.496(a), including subsequent amendments and editions. Optional Coverage Relocation Plans as permitted under section 105(a) (11) of the Act are to be approved by CA. (See Program Regulations 4 NCAC 19L Acquisition and Relocation .1003) Property management shall be provided in accordance with Rule .0908 and Rule .0909 of the Financial Management Systems section of Program Regulation 4 NCAC 19L.

Audit Objective

1. Determine whether the non-Federal entity complied with the real property acquisition, appraisal, negotiation, and relocation requirements.

Suggested Audit Procedures

1. Inquire of management and review the records of Federal programs to ascertain if the non-Federal entity administers Federally-assisted programs that involve the acquisition of real property or the displacement of households or businesses.

2. Property Acquisitions

For a sample of acquisitions:

- a. *Appraisal* – Test records to ascertain if: (1) the just compensation amount offered the property owner was determined by an appraisal process; (2) the appraisal(s) was examined by a review

appraiser; and, (3) the review appraiser prepared a signed statement which explains the basis for adjusting comparable sales to reach the review appraiser's determination of the fair market value.

- b. *Negotiations* – Test supporting documentation to ascertain if: (1) a written offer of the appraised value was made to the property owner; and (2) a written justification was prepared if the purchase price for the property exceeded the amount offered and that the documentation (e.g., recent court awards, estimated trial costs, valuation problems) supports such administrative settlement as being reasonable, prudent, and in the public interest.
- c. *Residential Relocations* – Test supporting documentation to ascertain if the non-Federal entity made available to the displaced persons one or more comparable replacement dwellings.