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**COMMUNITY DEVELOPMENT BLOCK GRANT/STATES'
PROGRAM AND NON-ENTITLEMENT GRANTS IN HAWAII**

**State Project/Program: COMMUNITY DEVELOPMENT BLOCK GRANT –
INFRASTRUCTURE FUND**

U.S. Department of Housing and Urban Development**Federal Authorization: Title I of the Housing and Community Development Act of 1974
(42 USC 5301)****NC Department of Environmental Quality
Division of Water Infrastructure**

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Division of Water Infrastructure

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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 Grant - Infrastructure Program is to improve the quality of life of low to moderate income people through funding water and wastewater infrastructure projects that improve water services or that mitigate environmental and public health hazards. The program provides grants for water infrastructure improvements projects to communities having a population that is at least 51% low to moderate income in the project service area as allowed by Title I of the Housing and Urban Development Act of 1974. The CDBG program is 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, which was revised effective May 23, 2012.

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 units of general local government that do not qualify for grants under the CDBG Entitlement Program. Three percent of the State's grant plus \$100,000 is allowed for administration of the program, with the State matching the three percent with an equal amount of State funding (24 CFR Part 570.489). The North Carolina Department of Commerce is the grantee for the State of North Carolina. Funds are allocated to the State from HUD based upon an established formula. Per S.L. 2013-360, the Department of Environmental Quality receives approximately 2/3 of the State's allocation to fund critical water and wastewater needs across the State. Units of general local government (municipalities and counties) may request CDBG grant funds from the Division of Water Infrastructure (Division) in the North Carolina Department of Environmental Quality (DEQ) through a competitive grant making process. A number of steps are followed in determining which local governments receive funding.

- Local government units that wish to seek funding must complete an application package (North Carolina Water/Wastewater Application Form, and attachments). Applications to the Division are reviewed and prioritized (i.e., ranked) based on information contained in the application, then presented to the State Water Infrastructure Authority (Authority) for approval.
- The Authority reviews the applications and staff ranking and then approves which projects are eligible for funding. A Notice of Intent to Fund letter containing deadlines and conditions is sent to the approved applicants.
- The Division prepares the contract. The contract mirrors the deadlines and benchmarks stated in the Notice of Intent to Fund letter, and may have additional conditions added. Missing a deadline may be grounds for deobligating the grant.
- Once the contract is executed, only funds in the Administrative line item may be accessed by the grantee. Activities in the Administrative line item include grant administration, the engineering report, and the environmental review.
- A Release of Funds letter is generated after the applicant completes the environmental review. After the Release of Funds letter is issued on a project, all funding is available for use by the grantee. Project design and plans and specs may then be developed and submitted to the Division for approval.
- Once plans and specs and design are approved, and all permits are in hand, the local units of government submit bid packages to the Division, which then authorizes awards by approving a standard set of documents.
- The recipient executes a Notice to Proceed as part of the contract documents. The Notice To Proceed establishes the construction start date, which is established in the contract.
- During construction, requests for payment are made to the Division with accompanying invoices, which are reviewed and approved, by the program's financial and technical staff. Modifications in the payment request are made for incorrect math, items over budget or contract or for ineligible costs. Any approved change orders in excess of 10% of the line item cost requires a contract amendment. Grant administration payments are capped at 60% of the budgeted amount until construction begins. At 95% complete, the Division reviews the total project and can hold payments until requested items such as sale tax certifications, engineer's certification on the project and certification of completion by the recipient have been received. The Certification of Completion states a date that construction was complete and accepted by the owner.

III. COMPLIANCE REQUIREMENTS

In developing the audit procedures to test compliance with the requirements for this Federal program, the auditor must determine, from the following summary (also included in Part 2, “Matrix of Compliance Requirements”), which of the 12 types of compliance requirements apply, and then determine which of the applicable requirements is likely to have a direct and material effect on the Federal program at the auditee. For each such requirement, the auditor must use Part 3 (which includes generic details about each compliance requirement other than Special Tests and Provisions) and this program supplement (which includes any program-specific requirements) to perform the audit.

A. Activities Allowed or Unallowed

1. The DEQ CDBG-Infrastructure Program is allowed to fund critically needed public water and wastewater infrastructure, and service connections to homes. Section 105(a) of the Housing and Community Development Act of 1974 lists the activities eligible under the CDBG State’s Program. For this program, these 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) relocation assistance; (d) planning activities; and (e) administrative costs.
2. Under the national objective criteria, 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 unit of general local government grantee must retain documentation justifying its certifications.
3. The CDBG public benefit standards prohibit funding the following activities:
 - (a) general promotion of the community as a whole;
 - (b) assistance to professional sports teams;
 - (c) assistance to privately-owned recreational facilities that serve a predominately higher-income clientele, where the recreational benefit to users or members clearly outweighs employment or other benefits to low- and moderate-income persons;
 - (d) acquisition of land for which the specific proposed use has not yet been identified; and
 - (e) assistance to a for-profit business while that business or any other business owned by the same person(s)/entity(ies) is the subject of unresolved findings of noncompliance relating to previous CDBG assistance provided by the recipient (24 CFR Part 570.482(f)(4)(ii)).

Audit Objectives

Determine whether awarded funds were expended for authorized projects, only.

Suggested Audit Procedures

Test a sample of transactions for conformance with the allowability of cost provisions or of limitations in the grant and the project review and cost summary document. Verify that costs are allowable.

B. Allowable Costs/Cost Principles

Compliance Requirements

Costs must be consistent with policies and procedures that apply to the CDBG-Infrastructure program. This includes guidelines and special conditions established by the agreement with the recipient. Allowable project costs are limited to the actual cost of the work described in the project application and indicated in the plans and specs, and grant administration costs. Costs are not allowed for expenditures for repairs, or operation and maintenance of any water/sewer system projects. Allowed and disallowed items are listed in 2 CFR Part 200.420 through 2 CFR Part 200.435; 2 CFR Part 200.437 through 200.440; 2 CFR Part 200.442 through 200.444; 2 CFR Part 200.446 through 200.454; 2 CFR Part 200.456 through 200.475. Items listed in 2 CFR Part 200.436, 200.441, 200.445, 200.455 are expressly prohibited by CDBG enabling regulations at 24 CFR Part 570.489(p).

Audit Objectives

To determine that project costs are allowable under the program rules.

Suggested Audit Procedures

Randomly select invoices in the financial files and compare the purpose to the allowable costs in Subpart E, *Cost Principles* of 2 CFR Part 200 for compliance.

C. Cash Management

All funds granted shall be expended solely for carrying out the approved project and an audit shall be performed according to regulations found at 2 CFR Part 200.500. The applicant shall expend all of the requisitioned funds for the purpose of paying the costs of the project within three (3) banking days following the receipt of the funds from the State. Please note that the State is not a party to the construction contract (s) and the grant recipient is expected to uphold its contract obligations regarding timely payment.

D. Reserved - Not applicable

E. Eligibility

Only units of general local government (municipalities and counties) are eligible for CDBG grants.

F. Equipment and Real Property Management – Not applicable

G. Matching, Level of Effort, Earmarking

Matching- Not applicable at the local level.

Level of Effort – Not Applicable.

Earmarking -

- a. No more than 10 percent of the total project cost may be budgeted or expended for administrative activities. Administrative activities include the development of regulatory plans for the grantee unit of general local government, and compiling information for the Annual Performance and Evaluation Report, and the semi-annual Labor Standards report sent to DEQ's

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CDBG-Infrastructure Unit. Administrators may also develop payment requests, and monitor for Davis-Bacon wage rate adherence during construction. The administrative line item also includes the environmental report and the engineering report required in each project. The administrative line item does not include construction administration, construction inspection, design, or plans and specs.

- b. A total of \$3000 from administrative funds may be used to compensate the grant writer if the application was qualified as eligible using census data to demonstrate low-to-moderate income (LMI) percentage. A total of \$5000 may be used to compensate the grant writer if the application was qualified as eligible using income surveys to demonstrate LMI percentage. In both cases, the grant writer has to have been procured using a Request for Proposal process, and documentation of the RFP process must be in the project file.
- c. Payments for administrative line items are capped at 60 percent of the administrative line item until after start of construction, defined as the date construction contracts are signed.
- d. The final 5 percent of the grant is withheld until a Final Report is approved by the DEQ CDBG-Infrastructure Unit.

H. Period of Performance – Three dates define the period of performance. All three dates are found in the contract between the local government and DEQ. The *Contract Expiration Date* is the date by which all work must be finished, and the final report is submitted. The *Final Reimbursement Date* is the date by which the final payment request must be submitted to DEQ. No payments will be processed after this date. The *Closeout Date* is the date by which the closeout package with final reports, forms and documentation of the final closeout public hearing is due to DEQ.

I. Procurement and Suspension and Debarment

Procurement is governed by the *CDBG-Infrastructure Procurement Policy*. Regulations at 2 CFR Part 200.101(d) exempt the State and Small Cities CDBG Program from most of Subpart D – Post Federal Award Requirements, Subpart C – Pre-Federal Award Requirements and Contents of Federal Awards, and Subpart E, Cost Principles. The Deputy Administrator of the State and Small Cities’ Program has advised States to develop their own procurement policy in writing, and utilize it.

Local governments are required to check the Federal and State debarment lists prior to executing contracts with professional and construction services. Documentation of that check (a printout from the SAMS.gov site and a printout from the state debarment lists) are to be filed in the local government’s procurement files.

Before a local government enters into a sole source contract, documentation of at least two attempts to procure services and goods must be submitted to the NCDEQ staff, along with a letter requesting permission to enter into a sole source contract. The procurement documentation, request letter and response letter from DEQ must be in the local government’s files.

Audit Objective

Determine whether procurements were made in compliance with the *CDBG-I Procurement Policy*.

Suggested Audit Procedures

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1. Test a sample of contracts and ascertain if the required suspension and debarment certifications were received for subawards and covered contracts.
2. Test a sample of contracts to the List of Parties Excluded from Federal Procurement or Nonprocurement Programs, issued by the General Services Administration and ascertain if contracts were awarded to suspended or debarred parties.
3. Test a sample of contracts and ascertain if the required suspension and debarment certifications were received for subawards and covered contracts.
4. Test a sample of contracts to the List of Parties Excluded from Federal Procurement or Nonprocurement Programs, issued by the General Services Administration and ascertain if contracts were awarded to suspended or debarred parties.

J. Program Income

1. The CDBG-Infrastructure program finances public utilities. No program income is expected.

K. Real Property Acquisition and Relocation Assistance – *See crosscutting requirements in section CC for real property acquisition and relocation assistance.*

L. Reporting

Financial Reporting

- a. SF-270, *Request for Advance or Reimbursement* – Not Applicable
- b. SF-271, *Outlay Report and Request for Reimbursement for Construction Programs* – Not Applicable
- c. SF-425, *Federal Financial Report* – Not Applicable
- d. *Performance and Evaluation Report (PER) (OMB No. 2506-0085)* – This report is due from each State CDBG grantee within 90 days after the close of its program year. The PER instructions are in Notice CPD-11-03 which is available at <https://www.hudexchange.info/resource/2298/notice-cpd-11-03-reporting-requirements-state-per/>. The auditor is expected to test only the financial data in this report (24 CFR sections 91.520 (a) and (d)). States have the option to submit the PER through the electronic Consolidated (eCon) Plan template which is available at <https://www.hudexchange.info/consolidated-plan/econ-planning-suite/>.

Performance Reporting

HUD 60002, *Section 3 Summary Report, Economic Opportunities for Low- and Very Low-Income Persons*, (OMB No. 2529-0043) – Each recipient that administers covered public and Indian housing assistance, regardless of the amount expended, and each recipient that administers covered housing and community development assistance in excess of \$200,000 in a program year, must submit HUD 60002 information using the automated Section 3 Performance Evaluation and Registry (SPEARS) System (24 CFR sections 135.3(a)(1) and 135.90).

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Information on the automated system is available at http://portal.hud.gov/hudportal/HUD?src=/program_offices/fair_housing_equal_opp/section3/section3/spears. The system was launched on August 24, 2015. The due date for submission of 2013 and 2014 reports was extended to December 15, 2015. SPEARS pre-populates Form HUD 60002 with recipient name and address along with disbursement data for program funding covered by Section 3. Users have the flexibility of selecting the 12-month reporting period, typically to coincide with their respective fiscal cycle.

Key Line Items – The following line items contain critical information:

- a. Number of new hires that meet the definition of a Section 3 resident
- b. Total dollar amount of construction contracts awarded during the reporting period
- c. Dollar amount of construction contracts awarded to Section 3 businesses during the reporting period
- d. Number of Section 3 businesses receiving the construction contracts
- e. Total dollar amount of non-construction contracts awarded during the reporting period
- f. Dollar amount of non-construction contracts awarded to Section 3 businesses during the reporting period
- g. Number of Section 3 businesses receiving the non-construction contracts

Quarterly Reporting

Quarterly reports are required in the contract between the DEQ CDBG-Infrastructure Program and the unit of general local government grantee. Quarterly reports are due in the DEQ office no more than 45 days after the end of each quarter (March 31, June 30, September 30, December 31). Copies of the quarterly reports must be in the project file.

Final Reporting

Prior to the reimbursement of the last five percent of the grant, a final report must be completed and submitted to the State. Upon approval of the report, the final five percent of the grant may be disbursed. The grant contract final report must parallel the scope and conditions of the grant contract as defined in Exhibit A of the contract.

M. Subrecipient Monitoring – Not applicable.

N. Special Tests and Provisions

The cross cutting requirements in the CDBG Program include Financial management/Procurement; Environmental review; Labor Standards; Acquisition/Relocation; and Fair Housing.

- 1) **Financial Management/Procurement** – *See Part I for procurement and suspension and debarment procedures.*

Audit Objectives

Determine whether goods and services were properly advertised, evaluated and procured, according to the policy developed for the CDBG-Infrastructure Program.

Suggested Audit Procedures

Review the advertising and documentation of the procurement of grant administrators, engineers, and the bidding of construction projects for compliance to the policy.

2) Environmental Review

Compliance Requirement – Projects must have an environmental review unless they meet criteria specified in the regulations that would exclude them from request for release of funds (RROF) and environmental certification requirements.

Audit Objective – Determine whether the required environmental reviews were conducted and required State approvals were obtained.

Suggested Audit Procedures

- a. Verify that the environmental review certifications are in the unit of general local government’s files.
- b. For any project where an environmental review was not performed, ascertain that a written determination was made that the review was not required. The written determination must be in the unit of local government’s files.
- c. 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.
- d. Verify that expenses for design, plans and specs were not paid from CDBG funds prior to the Request for Release of Funds is approved unless a letter is in the file from the chief elected official stating his/her understanding that design, plans and specs are exempt from environmental review, OR that the Release of Funds letter from the State allowing expenditure of CDBG funds on those activities is in the file.

3) Labor Standards

Compliance Requirement - The Wage Rate Requirements apply to the rehabilitation of residential property only if such property contains eight or more units. Rehabilitation of residential property includes the connection of homes to water and /or sewer. Therefore, if a water/sewer project connects eight or more units on a single property, Davis-Bacon wage rates apply. 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 (42 USC 5310). **For all other construction, Davis-Bacon wage rates apply.**

Audit Objective - Determine that workers were classified appropriately and paid at least the wage rate for the classification.

Suggested Audit Procedures – Select at least three random payrolls. Determine whether the workers were paid as classified, or higher.

4) Acquisition/Relocation

Equipment Acquisition and Management - Refer to 2 CFR Part 200.439, “Equipment and other capital expenditures” for rules regarding the purchase of equipment with project funds.

Audit Objective

To determine whether equipment was acquired per the procurement policy, and whether the local government has a tracking mechanism for the equipment.

Suggested Audit Procedures

Review the procurement of the equipment and question the local government on its use pertaining to the project. Determine whether the local government has an inventory control system in place to track the equipment.

Real Property Acquisition

Real property acquisition in CDBG programs is governed by regulations in 49 CFR Part 24.101. Real property must be voluntarily sold. If the real property is not voluntarily sold, the unit of local government may not move to condemnation to acquire the property, but must design the project around the unacquired property. Real property may be acquired through exercise of eminent domain, but only if there was no effort to purchase the land through a voluntary sale.

A formal appraisal is required if the land is valued at over \$10,000. Land valued at \$10,000 or less does not require a formal appraisal, unless the owner requests an appraisal.

Audit Objective

Determine whether the entity complied with the real property acquisition, appraisal, and negotiation required by the provisions in the program.

Suggested Audit Procedures

Test records to ascertain if: 1) a written offer of the estimated (\$10,000 or less in value) or appraised (>\$10,000) value was made to the property owner; and a 2) 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.

If the property is appraised, test records to ascertain if: 1) the appraisal was examined by a review appraiser; and, 2) 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.

Relocation Assistance

Relocation assistance in the CDBG program is governed by section 104(d) of the Housing and Community Development Act of 1974. In infrastructure projects, relocation is not anticipated to be long-term, rather it is anticipated to be short-term in the event that water or sewer service must be cut to residences, requiring residents to stay in a hotel for a night or two. CDBG funds may pay for the cost of the relocation (i.e., hotel bills).

Audit Objective

Determine whether the Relocation Assistance Plan established by the unit of local government was followed or not.

Suggested Audit Procedures

Review records to determine whether residents were displaced from their homes as a result of construction in the project. Review the Relocation Assistance Plan to determine plan compliance, and review financial documentation (invoices and receipts) to determine cost and payment for relocation.

5) Fair Housing

Compliance Requirement – Communities receiving CDBG funds must affirmatively affirm fair housing in their community.

Audit Objective

Determine whether the grantee is affirming the Fair Housing Act requirements.

Suggested Audit Procedures

Determine the status of the grantee’s Assessment of Fair Housing. Request to review a copy of the community’s Fair Housing Plan, and review the progress made on quarterly activities meant to further fair housing.

Wage Rate Requirements

Compliance Requirement - The Wage Rate Requirements apply to the rehabilitation of residential property only if such property contains eight or more units. Rehabilitation of residential property includes the connection of homes to water and /or sewer. Therefore, if a water/sewer project connects eight or more units on a single property, Davis-Bacon wage rates apply. 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 (42 USC 5310). **For all other construction, Davis-Bacon wage rates apply.**

Audit Objective - Determine that workers were classified appropriately and paid at least the wage rate for the classification.

Suggested Audit Procedures – Select at least three random payrolls. Determine whether the workers were paid as classified, or higher.

- c. 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.

- d. Verify that expenses for design, plans and specs were not paid from CDBG funds unless a letter is in the file from the chief elected official stating his/her understanding that design, plans and specs are exempt from environmental review, OR that the Release of Funds letter from the State allowing expenditure of CDBG funds on those activities is in the file.

Citizen Participation

Compliance Requirement

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

Audit Objective – Determine whether the CDBG grantee has developed and implemented a citizen participation plan.

Suggested Audit Procedures

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

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AUDIT REPORT

Project Description (Ex: Wastewater Facility)

Project Number

Municipality

For the Period _____ to _____

Statement of Revenues

Sources of Funds:	\$ _____
Local (Cash)	
Bond Sale Proceeds	_____
State Funds	_____
Federal Funds	
Identify Federal Program	
(grant or loan?)	_____
Other Sources	
Identify	_____
	\$ <u>_____</u>

Statement of Expenditures

Construction Cost	\$ _____
Contract I	
Contract II	
Engineering Fee	_____
Administrative Expense	
Identify	_____
Legal Fees	
Identify	_____
Other	
Land	
Interest, etc.	_____
	\$ <u>_____</u>