



## Key Components of Financial Management for CPD Grants

### Purpose

Financial management is the systematic application of procedures, forms, rules of conduct, and standards. As a grantee or subrecipient in receipt of Federal funds, your financial management practices must comply with the cost principles established by the Office of Management and Budget (OMB). This Bulletin is intended to identify components of a sound financial management system and offer guidance on avoiding some of the common challenges grantees face when managing Federal funds.

### The Importance of Sound Financial Management Practices

A well-organized financial management system is key to ensuring that Federal funds are used for their intended purposes and that program goals are achieved. Sound financial management practices:

1. Increase efficiency by reducing administrative burden and allowing the organization to spend more time administering programs and fulfilling its mission;
2. Promote integrity, transparency, and accountability by ensuring that all financial transactions are clearly documented using methods that are easy for both grantees and HUD to understand;
3. Ensure that all expenditures are accounted for within the budget;
4. Facilitate compliance with all applicable regulations including Federal cost principles, program-specific requirements, and local rules.

### Key Components of Financial Management

This Bulletin addresses five of the seven key components of financial management: 1. budgeting; 2. accounting and records; 3. cost principles; 4. reporting; and, 5. audits. The other two components, procurement and internal controls, are the subject of previous Integrity Bulletins, which can be found [here](#).

#### 1. Budgeting

Budgeting is a key component of financial management because it provides the overall plan for spending, both across the organization and on specific activities, within a given timeframe. Budgeting requires accounting for both revenues and expenditures at unit, project, and program levels. Budgeting also provides an ongoing check for reasonableness by comparing actual expenditure requests against projected expenditures. Budgets should be included in contracts and written agreements so



that partners know how much and on what the money should be spent.

#### Example of failure to follow a budget

A recent OIG audit found that a HOME grantee exceeded the amounts specified in its subrecipient agreements by more than \$900,000. Although the expenditures reviewed were supported by backup documentation, it was not clear if these costs were also charged to other federal funding sources. The grantee should have reviewed the total sources and uses of funds to determine whether the deviations from the agreed-upon budgets resulted in duplicative or excessive payments of Federal funds.

#### *Budgeting Tips:*

- Include program income in the budgeting process. Program income is the gross income received by grantees and their subrecipients generated by the Federal grant funds. Unless otherwise stated by the grant regulations or the terms and conditions of the Federal award, [2 CFR Part 200.305\(b\)\(5\)](#) requires program income to be used for current costs prior to drawing from the Federal line of credit.
- Manage budgets to ensure timeliness. Timeliness refers to how quickly grantees and recipients are able to commit and expend grant funds.
- Keeping up to date with commitment and expenditure schedules, attainable benchmarks, and alternative plans are essential to staying on track with spending.
- Minimize the time elapsing between the drawdown of funds and disbursement.

## **2. Accounting and Records**

Accounting is the next key component of financial management because it ensures that program costs and expenditures are recorded and documented properly. Fund accounting, the type of accounting used by HUD grantees, is a method of recording data based on the sources and uses of funds.



All accounting must meet published standards for accountants, Generally Accepted Accounting Principles (GAAP). Uniform accounting standards exist to help ensure consistency and transparency. Accounting records must include reliable, up-to-date information on the sources and uses of funds, including:

- Amount of Federal funds received
- Current authorization of funds
- Obligations of funds
- Unobligated balances
- Assets and liabilities
- Program income
- Actual expenditure broken down by the grant program and year for which the funds are derived and the activity on which the funds were used

Funds must be spent on eligible items and expended from the appropriate grant source. All spending should be approved by appropriate personnel. The accounting entries must match supporting documentation.

Example of failure to document the sources and uses of grant funds

An OIG audit revealed that a grantee established a grant and a loan program to help victims of a natural disaster. Of 12 voucher drawdowns reviewed, 4 did not identify the type of funding (loan or grant) and 8 did not show where funds were spent or applied. Additionally, the total for these eight voucher drawdowns was approximately \$1.2 million; however, supporting invoices amounted to \$1.36 million. The grantee should have ensured that staff had received adequate financial management training and that its accounting system was capable of recording the sources and uses of the grant funds.

*Accounting Tips:*

- Mistakes inevitably happen, but when they do, correct them as soon as possible. Use adjusting journal entries and correction memos to explain the adjustments.
- Periodic comparisons of financial records to actual assets and liabilities (i.e. reconciliation) should be conducted. In cases where discrepancies are found, corrective action must be taken to resolve such discrepancies.

### 3. Cost Principles

Federal cost principles are a key component of financial management because they keep ineligible and excessive spending in check. Cost principles are the regulations that determine eligible costs for specific activities, which are outlined in grant agreements and contracts. Cost principles for Federal, state, and local governments and nonprofit organizations are similar, but there are important differences. In 2013, OMB revised OMB financial management circulars A-21, A-87, A-110, A-122, A-89, A-102 and A-133 into 2 CFR Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, effective after December 26, 2014, which updates and defines allowability of costs for all Federal grants. In addition, grantees and subgrantees must comply with state and local law regarding cost reasonableness.



To be allowable under Federal awards, costs must be:

- Necessary and reasonable to carry out the award
- Authorized (or not prohibited) under Federal, state or local laws or rules
- In conformance with OMB guidance
- Consistent with state and local government activities
- Treated consistently
- Allocable to the award-funded activities
- Consistent with Generally Accepted Accounting Principles (GAAP)
- Not used for cost sharing or matching requirements of any other Federal award, unless specifically allowed by OMB
- Adequately documented

### Example of unreasonable costs

An OIG audit found that a grantee had charged its housing rehabilitation program more than \$127,000 in salary and fringe benefit costs when it spent only \$11,740 on program activities to help one participant rehabilitate a home. The grantee should have determined the demand for the housing rehabilitation program through the citizens' participation plan or during the application process. If the demand was not sufficient, the program should have been canceled with minimal administrative cost incurred.

### *Cost Allocation Tips:*

- No accounting system can make cost allowability or reasonableness determinations. Staff must be trained in the requirements and have a go-to person who knows the program regulations.
- Organizational leadership is required to set the tone from the top that spending must be reasonable.
- Allowable costs include (but are not limited to):
  - Personnel costs (salaries and benefits) for time devoted to performance of duties funded through the award
  - Cost of materials specifically for the purpose of the award
  - Equipment and other approved capital expenditures
  - Travel expenses incurred specifically to carry out the award
  - Costs that are specifically mentioned in the award regulations as allowable
- Unallowable costs include (but are not limited to):
  - Entertainment costs
  - Costs of legal defense related to civil or criminal fraud
  - Contributions or donations
  - Fundraising costs
  - Lobbying costs
  - Costs that are prohibited by award regulations

## **4. Reporting**

The fourth key component of financial management is reporting because it summarizes for the grantee and HUD the fiscal and programmatic activities and shows whether the program



is attaining its objectives. HUD programs require annual reporting through mechanisms including the Annual Performance Report, the Consolidated Annual Performance and Evaluation Report, and the Financial Summary Report. In addition, HUD uses the Integrated Disbursement and Information System and the Disaster Recovery Grant Reporting System to track financial performance. Grantees should have procedures that provide for the accurate reporting of receipts and expenses in those systems. To achieve successful

reporting, recipients must ensure the following:

- Setting up the grants in the system
- Collecting data, including creation and updating of forms for collection
- Analyzing data for accuracy and completeness
- Submitting data via the HUD-required system
- Applying quality control
- Posting reports publicly for the community, if required

### *Reporting Tips:*

- Establish reporting calendars for both internal use to management as well as official reports to the grantee or HUD.
- Assure time for review and sign-off.
- Ensure reports match accounting records.

## **5. Audits**

Audits are the final key component of financial management because they provide an independent and objective review that determines if the accounting records are accurate. An A-133 audit (Single Audit), is required for expenditures of \$750,000 or more in Federal awards during the grantee's fiscal year. It is important to know what you can and cannot learn from audits conducted by Independent Public Accountants (IPAs). You can learn from your IPA: the financial condition of the entity; the reliability of the financial records; internal control weaknesses, if any; and possible fraud, but the scope of the audit does not always assure all fraud will be found.

You will not learn from your IPA: whether you are in compliance with all laws and rules; and if the funds spent are all eligible, allowable, and reasonable under 2 CFR Part 200.



### Example of audit not completed

An OIG audit conducted in 2013 found that a certified public accountant ended its engagement with a grantee for its 2011 and 2012 financial statement and single audit reports required by HUD. The accountant told OIG auditors that a key issue with the grantee was a lack of supporting documentation for the entries in its QuickBooks accounting system. The grantee constantly revised its accounting figures, payroll allocations, revenues, and expenses. In one submission to the accountant, the expenses exceeded the revenues, and in a later submission, the revenues exceeded the expenses. The grantee's president informed OIG auditors that items had not been charged to the correct grants and that the audits for 2011, 2012, and 2013 needed to be completed. Based on the constant adjustment of accounting transactions, OIG deemed the accounting system data to be unreliable and unauditible. Grantees should ensure that employees have sufficient knowledge of the rules of the respective programs and of proper accounting systems. Grantees should attend HUD training courses and request technical assistance from HUD if the training proves insufficient for proper implementation of HUD programs.

### *Audit Tips:*

- The management letter from the IPA is probably the most informative of the information received. Pay attention to the letter and footnotes that often disclose operational weaknesses or accounts showing previously unknown activity.
- Since the management letter is not a comprehensive evaluation on the internal controls (but rather just a by-product of the audit process), the grantee or subrecipient must decide whether further outside evaluation of the systems and

procedures is warranted based on the audits findings. Subrecipient audit findings should also factor into the grantee's monitoring plan.

- Issues arising from prior year's management letters should be revisited to make sure they have been addressed to the IPA's satisfaction.
- Do not hire the accountant who does the fee accounting to also do the audit. There is a conflict of interest in that situation.
- Whether a grantee has an IPA audit or not, it is still required to maintain accurate records and is subject to additional audits by the HUD OIG or General Accountability Office at any time.

### **Summary**

Sound financial management helps grantees, the public and HUD ensure that Federal funds are used appropriately for their intended purposes. Grantees and subrecipients must know and adhere to Federal cost principles and other financial directives from OMB. Budget management, accounting and record keeping are essential tools to assure finances are administered properly. Annual audits, as required, provide an important element of grant oversight, and grantees and subrecipients should assure their records are always ready for audit.

If you have questions regarding financial management, contact your local CPD representative.

**Allegations of fraud in CPD programs must be reported to your local HUD Office of Inspector General or to the HUD OIG hotline at <http://www.hudoig.gov/report-fraud>.**