CHAPTER 5

MONITORING

WHICH GRANTEES WILL BE MONITORED

Monitoring is determined by completing a risk assessment of each grantee. Components considered in the risk assessment process include (but are not limited to):

> Jurisdictions "exempt" from Single Audit submission,
> Single Audit Compliance (missed or late reporting, findings, etc.),
> Number of Open Contracts,
> Contract Activities,
> Program Income,
> Length of time since last monitoring,
> Advance payments processed for contract, and
> Nomination from staff/management.

COMPONENTS

1. NOTIFICATION/EDUCATION

From the onset, each CDBG-NDR Grantees' interaction with any existing and/or potential contractors will impact the success of CDBG-NDR projects. Educating contractors as early in the process as possible by establishing open lines of communication, providing specific CDBG-NDR and Federal program requirements, as well as general contract terms will provide a better understanding of the contract's terms and conditions and will identify the areas that will be measured by monitoring and auditing agencies.

Be proactive. Provide each contractor clear, concise and unambiguous written communications:

- Clear expectations and deadlines (at minimum, include these in the solicitation and contract documents)
- Detailed statement of work
- Purpose of the contract, performance measures/goals, entity's methods for monitoring performance, deliverables, and other requirements
- Contract contains contractor's responsibilities (activities, products, and timetables for completion)
- Penalties and/or consequences for non-performance
- Performance measures and goals
  - o Include in the solicitation document
  - o Quality and quantity of services provided
  - o Outcomes (quality and quantity or result of the service)
  - o Output (process and units of the service)
  - o What, how, and when data will be collected by the contractor and to whom the data will be submitted

Education within your entity is also important. Even if your entity does not have monitoring staff,

incorporate the following components in your program administration and accounting areas:

- Contract requirements
- Entity's programs
- Entity-specific processes
- Fraud red flags
- CDBG-NDR terms and conditions
- Reporting and calculation requirements

2. INITIAL CERTIFICATION/ASSURANCE

An initial certification or assurance process should be completed prior to finalizing the contract with the contractor. This prequalification step ensures that the contractor can fulfill all contractual requirements, including CDBG-NDR requirements, and has the qualifications to perform under the contract.

The initial certification/assurance process can be achieved through a checklist similar to [Attachment I (Monitoring)](). Entity personnel would complete the form which includes reviewing, verifying, and attaching the contractor's individual certifications of CDBG-NDR requirements. Please refer to your Federal department for program-specific requirements.

3. CONTRACTING/PURCHASING

Separate contracts are required for sub-recipients, Grantees, or contractors receiving CDBG-NDR funds that have other existing contracts. All CDBG-NDR contracts must be registered in the Federal Central Contract Registry and possess a [Data Universal Numbering System (DUNS) number]().

In addition to your entity and related federal departments' existing mandatory contract terms, the following supplemental terms and conditions must be included in any CDBG-NDR contract:

A. CDBG-NDR Funded Project
B. Enforceability, funds can be taken away
C. Prohibition on use of CDBG-NDR funds
D. Allowable/disallowable expenses
E. Administrative/overhead expense limits
F. Required use of American iron, steel, and other manufactured goods
G. Wage rate requirements
H. Detailed budget
I. Inspection of records subject to audit
J. Record retention
K. Whistleblower protection
L. False claims act
M. Reporting requirements

Contract terms should include:

- 10% retention clause for payments to subcontractors

- Requirement for regular programmatic reports to be provided at designated intervals
- Reporting method
- An outline of the required report contents
- Report template in the appendix
- Entity individual who should receive the report
- Actions the entity will take if a report is incomplete or delinquent

In addition, dispute resolution procedures should be included in the contract to address, mitigate, and resolve problems before they escalate. Clear, concise contract language should limit the potential for dispute. Resolution of minor disagreements between the service provider and the monitors should be documented and filed in the monitor's work papers. When an issue is significant, the resolution procedures should:

- Require notification to the entity's procurement office and provide written notification with a timetable for resolution to the contractor. If not resolved, the program section and/or procurement office should be notified.
- Detail and indicate the level of noncompliance at which a contractor will receive notification of potential contract termination.
- Detail the required procedures for the contractor's appeal and describe the administrative action taken by the entity.
- Settle appeals by negotiation or arbitration.

4. INITIAL RISK ASSESSMENT

For monitoring purposes, risk is defined as the probability or likelihood of an event or action having an adverse effect on an entity. The "Initial Implementing Guidance for the American Recovery and Reinvestment Act of 2009" from the Federal Office of Management and Budget (OMB 2-18-09) states that risk mitigation actions must address:

- Audits and investigations of CDBG-NDR funds to identify and prevent wasteful spending and minimize waste, fraud, and abuse
- Qualified personnel overseeing CDBG-NDR funds
- Competitive awards maximized
- Timely award of dollars
- Timely expenditure of dollars
- Cost overruns minimized
- Improper payments minimized

Risk assessments provide information about trends in contractors' activities and identify which contractors require monitoring and establish what level of monitoring is needed. The entity can provide a template to the contractor for self-certification (Attachment B – Contractor's Self-Assessment). Upon its receipt, the entity reviews the results to determine high-risk areas that require follow-up or more in-depth review. Assessing contractor compliance based on a self-

certification would include the review of:

- Contractor's reporting compliance
  - o Accuracy
  - o Timeliness
- Contractor's audit history
  - o Findings from prior audits still outstanding
  - o Any current findings from independent single audits
  - o Any current findings by other audit agencies

In addition, the outcome of the risk assessments (specific risk areas) will identify those contractors that require more in-depth oversight and monitoring.

- Review the contract file:
  - o Signed contract and purchase order
  - o Contract modifications
  - o Contract administration plan
  - o Contingency plan
  - o Sources solicited
  - o Evaluation method and award
  - o Meeting minutes
  - o Contract correspondence
  - o On-site visit reports
  - o Performance reports
  - o Records of complaints and contractor disputes
  - o Invoices and vouchers.

- Review of fund disbursements should include:
  - o Size of the funds awarded
  - o Funds not being disbursed timely or too quickly
  - o Comparison of funds awarded vs. funds spent
  - o Meets timeline in the contract
  - o Comparison of funds reported to funds disbursed
  - o Which activities had funds distributed to them.

- Review of internal controls should include:
  - o Contractor has documented policies and procedures
  - o Designated people are doing what they agreed to (e.g., signing reports, requesting funds)
  - o Segregation of duties and evidence that they were adhered to and followed.

- Review of industry trends:
  - o Incorporate issues from other contractor's findings
  - o "Lessons learned" – add questions from results of other monitorings.

5. ROUTINE MONITORING
Key Components for Successful Monitoring

An effective monitoring program is essential to ensure CDBG-NDR funds are utilized as required by the American Recovery and Reinvestment Act, follow related Federal circulars and laws, and follow the terms and conditions as stipulated in the contract. As the prime recipient, you are responsible for your contractor's uses and disbursement of the funds and/or the effectiveness of the program.

Even if your entity does not have staff designated for oversight and monitoring, most of these monitoring concepts can and should be incorporated into your program administration and accounting policies.

Successful monitoring systems include**:**
- Good work practices
- Consistent processes
- Written policies and procedures
- Separation of duties
- Contract files containing all pertinent documentation
- Master list of contractors
- On-site monitoring
- Access rights to records/right to audit.

A. **PRE-SITE VISIT MONITORING**
   Pre-site monitoring is recommended prior to on-site monitoring visits and is effective in entities without staff specifically assigned to ongoing monitoring. Pre-site monitoring can be accomplished through a list of requirements, identified topics, or probative questions introduced on a checklist, survey, questionnaire, or interview. The contractor's responses to the requirements, identified topics, or questions help reduce or indicate that further monitoring is required.

   The pre-site monitor instrument should contain general and program-specific questions that will provide the monitors with key information. If your entity has a current pre-monitoring instrument, please review it to ensure that CDBG-NDR-related requirements have been incorporated.

   Attachment C (Monitoring) provides an example of questions for pre-site monitoring for procurements or contracts for services that help determine what additional monitoring steps should be taken. Once the contractor returns the completed questionnaire to the entity (prime recipient), the entity's monitors review the responses to determine what additional actions are needed. Additional actions may include a letter with recommended action plans, a schedule for obtaining additional information, and/or follow-up monitoring site visits.

Status reports that provide a summary of planned and completed activities are another example of a pre-site monitoring tool. Consideration should be made for the complexity of the contracted services, the contract value, and the potential of (poor) performance risk to the entity. Early intensive monitoring in the contract period is beneficial to ensuring good performance on the contract. The status report should focus on:

- Deliverables
- Milestones
- Performance measurements
- Contract modifications
- Summary of invoices submitted and paid
- Contract renewal dates
- Individual responsible and method for monitoring each contract aspect
- Detailed line item budgets.

B.   **ON-SITE MONITORING**

On-site monitoring may incorporate one or more activities to gather information for the monitor's review. Interviews, documentation review, observation, contractor questionnaire, and analysis performed by the monitor are examples of some of these activities. A checklist of tasks to be performed provides the monitor the structure needed to gather information for compiling a written report detailing findings of the review. Methodology and the checklist of tasks to be performed will depend on the nature of the contract and program and the utilization of CDBG-NDR funds.

Attachment D lists questions to consider during your on-site visit. These questions solicit general and CDBG-NDR-specific answers. Incorporating a value/grading/ranking system for the questions helps identify contractors that require further ongoing monitoring and will provide information about those contractors that have been placed on probation, had payments withheld, and/or had contracts terminated.

If appropriate, notify the contractor about the pending on-site visit and required documentation. This will facilitate the monitoring process and progress.

In general, an on-site monitoring visit will verify that:

- All documents associated with the CDBG-NDR funds are

maintained together and readily accessible

- Prior audit finding corrective actions have been implemented
- Persons of authority and identified for designated responsibilities (in the contract) are present and performing their delegated duties
- The objectives of the grant are being accomplished
- Written policies and procedures for management functions and program operations are maintained and up-to-date
- Written policies and procedures are not being ignored or overridden
- Adequate equipment and asset management procedures are in place

i. **FISCAL**
- Invoice review
  - o Submitted in a timely manner and on an apparent schedule
  - o Are items charged on a line item or fixed fee basis
  - o Services/product description
  - o Match to purchase order
  - o Approval process
  - o Verify that invoice expenses are allowable per contract requirements

- Cash Management
  - o Perform a budget to actual comparison
  - o Analyze cash on hand
  - o Review the contractor's policy and use of cash advances
  - o Review the contractor's policy on cash advances and how the cash advance is recovered
  - o Evaluate the reconciliation procedures
  - o Verify that there are safeguards for credit/debit cards, petty cash fund, other cash transactions

- Budget changes should
  - o Be approved by appropriate entity representative
  - o Be documented in a contract amendment
  - o Be included in the contract file

- Cost allocation analysis
  - o List disbursement information (date, check number, vendor, amount, and notes)
  - o Review written cost allocation plan (CAP) and the cost pools
  - o Review occupancy costs
  - o Confirm direct and common costs are identified and separate
  - o Verify allocation base for each cost pool

- o Validate most recent allocation was done in accordance with the CAP
- o Verify cost pool is reduced to zero monthly

- Subcontracts
  - o List contract information (agency, dates, award, and amount)
  - o Select sample of contracts – expand if there are issues
  - o Verify that the sub-contracts have cover page, terms and conditions (including CDBG-NDR), attachments/forms, program plan (CAP), budget, modifications
  - o Review the subcontractor budgets for consistency with CAP, proper invoices, line item budget detail, cost reimbursement or fixed fee stated, cost per unit if fixed fee
  - o Confirm that the contractor is maintaining and updating the list of subcontractors, has separate subcontractor files, tracks payments, monitors subcontractor's disbursements and services, follows up on finding resolutions
  - o Review invoices (see above)

- Direct Labor
  - o Select a sample of employees charged to the program
    - ✓ Confirm written job descriptions
    - ✓ Verify labor costs are charged to the proper award and time period
    - ✓ Review timesheets for
- Timely preparation
- Signed by employee and supervisor
- Account for all of the employee's time
- Calculation is correct
- Timesheet matches wages paid
- One timesheet per pay period per employee

- Other Direct Costs
  - o Select a sample of direct costs
    - ✓ Compare costs to invoices and purchase orders
    - ✓ Verify that purchase order approval was prior to purchase date
    - ✓ Confirm that invoice was verified, approved, cancelled
    - ✓ Validate the cost is program related
    - ✓ Review justification for equipment purchase and determination as the best option
    - ✓ Recalculate computations on purchase order and invoice
    - ✓ Review cost for reasonableness and necessary for the program
    - ✓ Analyze the line code postings and invoices

- Reporting
  - o Verify that the accounting system and financial reporting use the same basis (i.e., cash vs. accrual)
  - o Review the submitted financial reports to the contractor's accounting system
  - o Subcontractor information reported agrees with actual contractor's subcontractor files

ii. PROGRAMMATIC

Verify results in the Federal reports to contractor's documentation

- Services outlined in the contract have been delivered
  - o Utilizing surveys, questionnaires, and/or checklists
    - ✓ Survey recipients of delivered services
    - ✓ Interview service providers
    - ✓ Visual observation (e.g., construction completed; training documentation/media)
    - ✓ Review contractor's files using a formatted questionnaire/checklist

iii. ADMINISTRATIVE

Review contractor's progress and documentation

- Contractor submits required documentation timely
- Comparison of projected and actual fund disbursements
- Analysis of outputs and outcomes
- Jobs calculations and reporting

6. EXTENDED MONITORING

The on-site monitoring process may not provide comprehensive, and/or final results, and additional monitoring will be needed to determine whether the contractor is meeting their contract requirements. Because contract requirements may be different for each contractor, extended monitoring action, if needed, must incorporate specific activities that relate to the outcomes and results of the on-site monitoring visits. An extended monitoring process, once established, should:

- Identify and document the specific contractors who need further monitoring
  - o List the areas that require additional monitoring
  - o Develop monitoring activities for those areas
  - o Complete the extended monitoring timely

- Include random sampling techniques for reviewing areas that have multiple records. Using a set pattern (e.g. reviewing every 3rd or 10th record) provides a good representation of that area
    - o   Purchase orders
    - o   Invoices
    - o   Disbursements
    - o   Timesheets
    - o   Payroll records
    - o   Report calculations

- Document lessons learned
    - o   Communication is vital for both the monitors and the contractors. It will ensure that corrective action is monitored and taken. Capturing issues, resolutions, and questions and answers will serve as a reminder for monitors to "check" other contractors who can initiate corrective action, if and when needed
    - o   Updates to program guideline changes are essential to the program's future activity in negotiating, contracting, monitoring, and reporting. It ensures that consistency will continue in the program, procedures, and reports.

- Errors on monitor's behalf do occur
    - o   Review the monitoring results to the contractor's records
    - o   Update monitoring report and, if applicable, audit resolution tracking system

7. FOLLOW UP/CORRECTIVE ACTION

Your entity has the responsibility for following up on the corrective action recommendations for your entity and contractors. An active follow-up/corrective action process communicates the expectation of performance according to the contract and the importance of implementing the corrective action. It also ensures that the corrective action has been implemented.

- An audit finding tracking system should include the following:
    - o Document audit resolution process and procedures
    - o Assignment of audit findings to appropriate personnel to resolve findings
    - o Contractor's responses about corrective actions recorded and tracked
    - o Periodic review to determine when audit findings have been outstanding for over six months
    - o Findings analyzed
        - ✓ Same finding(s) for different contractors

- Is contract unclear?
- Is contract incomplete?
- Does contract contain any conditions that cannot be met?
- Is the program communicating expectations?
- Is the program providing guidance?
  o Contractor's prior finding(s) have not been resolved – or have returned
    ✓ Multiple significant findings for an individual contractor – contractor is ignoring terms and conditions
- Consequences if the contract goals are not achieved include:
  o Liquidated damages – calculate the entity's loss for poor performance and deduct that loss from payments to the contractor
  o Partial takeover of operations – entity takes over operation in non-compliant areas and reduces payments by new operating costs
  o Contract termination – used when the contractor has been given a clear warning about non-compliance and does not take corrective actions
- Evaluate audit findings to determine if findings should be disclosed in the state entity financial records

In the event that a contractor does not agree with and/or implement the corrective action(s) within the specified timeframe, the entity has the responsibility to act immediately in enforcing CDBG-NDR requirements. These types of actions should be stipulated in the contract and include:

- Strict oversight, dispute resolution, alerting other state entities, and discontinuing future contracts.
- Withhold payments until the monitors have verified that the contractor has made the corrections.
- In the event that the contractor ignores higher risk areas, the entity cancels the contract and replaces it with the "runner-up."

8. MONITORING CLOSE OUT/FINAL CERTIFICATION

A comprehensive monitoring program includes contract close out and certification of the contractor's performance. This process should be documented and performed at the close of all contracts. Close out reviews provide insight on both the contractor's performance and the entity's monitoring methods. It can be accomplished by:

- Completing a checklist that is tailored to address and review the contracted services
  o All invoices paid
  o All property returned
  o All deliverables/reports accepted
  o All report calculations verified
  o No lawsuits pending
  o Pending corrective actions/findings resolved

        o If applicable, contract audit completed

        o No outstanding changes or amendments

        o All security badges/keys returned

        o All disallowed costs settled

- Performing a final site inspection to verify actual performance (e.g. construction completion)
  - o Visual observation of completed work
  - o Review and verification of contractor's documentation pertaining to the contract
  - o Verification of accuracy in the contractor's calculations and reporting

Results from the close out process provide the entity with information about past performance and facilitate improvement for future contracting and monitoring:

- Contractor performance evaluation
- Determine if contractor has adequately fulfilled contract terms
- Identify those contracts with negative performance
- Include a financial audit if determined that risks make it necessary
- Entity's contract monitoring methods evaluation
- Contractor has adequate understanding of expectations
- Policies and procedures sufficiently address issues that arose during the contract period
- Contract administration plan allowed the agency to properly and quickly assess the contractor
- Entity personnel have the skills to monitor the contractor
- Incentives and penalties improved the contractor's performance when they were used
- If applicable, dispute resolution procedures were adequate

9. CDBG LOAN SERVCING AND PORTFOLIO MANAGEMENT

CDBG-DR and CDBG-NDR Grantees must have financial management systems in place to provide effective control over and accountability for all funds, property and assets, as well as being able to identify the source and application of funds for the property and assets.

"Loan" means to provide funds to a borrower in return for a promise to repay the principal, and any interest (if applicable).

"Portfolio" means all of the existing loans held by the Grantee in a particular program or group of programs.

The principles of effective loan portfolio management are:
- Institutional commitment to recovering funds,

- Active management of the portfolio,
- Comprehensive systems planning,
- Written policies and procedures,
- Complete documentation of loans, and
- Dedication to staff training in all aspects of the portfolio management process.

Loans are an asset of the program, and must be tracked until the loans are repaid. CDBG-DR and CDBG-NDR Grantees engaging in activities that include making loans or grants that have conditions to be maintained until a future date, or have invested CDBG-DR or CDBG-NDR funds for publically held properties acquired and/or improved through rehabilitation or construction must have current Loan Portfolio Policies and Procedures that comply with HUD standards per 24 CFR Part 570 and OMB requirements of 2 CFR Part 200.

Loan servicing begins immediately after the close and continues for the term of the loan. The loan documents (Note, Loan Agreement, Deed of Trust, Regulation Agreement, Development Agreement, Loan Program Agreement, etc.) must detail the requirements to be performed by each party of the loan.

Economic Development loans typically have additional requirements that must be met, which requires more hands-on management than a deferred payment loan. Adequate follow up with borrower allows the early identification of any potential problems and the opportunity to avoid small concerns from developing into a situation that will put the loan performance at risk.

Each Grantee's Loan Portfolio Policy must contain an Asset Management Plan, which addresses the policies for managing compliance on a day to day basis to ensure compliance with the terms of the loans and grants, including any occupancy, insurance and taxes payment requirements, household income limitations, or remedies for non-performance. The Asset Management Plan must include the reporting periods and requirements for the borrowers' compliance, as well as notification steps to be taken for default and/or noncompliance loans, such as the force-placement of hazard insurance. A schedule outlining the method and timing of staff reporting loan portfolio performance to upper management, along with a standard for the involvement of legal counsel is essential to the Grantee's loan portfolio health.

The Asset Management Plan must include the actions required for managing defaults and/or non-compliance of payments or any other requirements, under the loan, collateral and/or security agreements. The plan must include steps the Grantee will follow once it identifies a default or noncompliance, include the use of foreclosure, waiving of any defaults, its restructuring standards, and its standards for charging off loans. The Asset Management Plan must itemize any exceptions the Grantee will consider, and must not make expand the allowable exceptions on a case-by-case basis to ensure uniform treatment.

HCD MONITORING OF CDBG-DR AND/OR CDBG-NDR ACTIVITIES

Monitoring is an integral management control technique and is critical to ensuring the funding is being used as it was intended and awarded, is being spent in a timely manner, and is serving the

appropriate population. CDBG-DR and CDBG-NDR activities will be monitored using the procedures outlined in HCD's CDBG Grant Management Manual (GMM), Chapter 12, *CDBG Grant Monitoring Handbook*. The GMM is located at: http://www.hcd.ca.gov/financial-assistance/community-development-block-grant-program/manual/ .

In addition to detailing the process for monitoring, the *CDBG Grant Monitoring Handbook* includes monitoring checklists. Grantees are strongly encouraged to become familiar with the checklists prior to beginning the activities, and to revisit the checklists periodically throughout the process to ensure all components of compliance are being met.