

CAA Leaders' LEGAL GUIDE

A publication by CAPLAW and the Community Action Partnership

(paragraph (c)(5) of this section) also applies to earnings on debt service reserve funds.

(2) The non-Federal entity will negotiate the amount of allowable interest cost related to the acquisition of facilities with asset costs of \$1 million or more, as outlined in paragraph (c)(7) of this section. For this purpose, a non-Federal entity must consider only cash inflows and outflows attributable to that portion of the real property used for Federal awards.

(e) Additional conditions for IHEs. For costs to be allowable, the IHE must have incurred the interest costs after September 23, 1982, in connection with acquisitions of capital assets that occurred after that date.

(f) Additional condition for nonprofit organizations. For costs to be allowable, the nonprofit organization incurred the interest costs after September 29, 1995, in connection with acquisitions of capital assets that occurred after that date.

(g) The interest allowability provisions of this section do not apply to a nonprofit organization subject to "full coverage" under the Cost Accounting Standards (CAS), as defined at 48 CFR 9903.201-2(a). The non-Federal entity's Federal awards are instead subject to CAS 414 (48 CFR 9904.414), and CAS 417 (48 CFR 9904.417).

§75.450 Lobbying.

(a) The cost of certain influencing activities associated with obtaining grants, contracts, cooperative agreements, or loans is an unallowable cost. Lobbying with respect to certain grants, contracts, cooperative agreements, and loans is governed by relevant statutes, including among others, the provisions of 31 U.S.C. 1352, as well as the common rule, "New Restrictions on Lobbying" published at 55 FR 6736 (February 26, 1990), including definitions and the Office of

Federal award or regulatory matter on any basis other than the merits of the matter.

(c) In addition to the above, the following restrictions are applicable to nonprofit organizations and IHEs:

(1) Costs associated with the following activities are unallowable:

(i) Attempts to influence the outcomes of any Federal, state, or local election, referendum, initiative, or similar procedure, through kind or cash contributions, endorsements, publicity, or similar activity;

(ii) Establishing, administering, contributing to, or paying the expenses of a political party, campaign, political action committee, or other organization established for the purpose of influencing the outcomes of elections in the United States;

(iii) Any attempt to influence the introduction of Federal or state legislation;

(iv) The payment or expenditure of any pending or contemplated litigation through commercial means;

(v) The enactment or modification of any pending Federal or state law by preparing, distributing, publishing, or propagating by any means, members of the general public or any segment thereof, to contribute to or participate in any mass demonstration, march, rally, fund raising drive, lobbying campaign or letter writing or telephone campaign, or

(vi) Any government official or employee in connection with a decision to sign or veto enrolled legislation;

(vii) Legislative liaison activities, including attendance at legislative sessions or committee hearings, gathering information regarding legislation, and analyzing the effect of legislation, when such activities are carried on in support of special interests;

(viii) Any activity that is prohibited by the Internal Revenue Code provisions that require nonprofit organizations to limit their participation in direct and "grass roots" lobbying activities in order to retain their charitable deduction status and avoid alternative excise taxes, IRC secs. 501(c)(3), 501(h), 4911(c), and 4911(d);

(ix) Nonpartisan analysis, study, or research reports;

(x) Examinations and discussions of broad social, economic, and similar problems; and

(xi) Information provided upon request by a legislator for technical advice and assistance, as defined by IRC sec. 4911(d)(2) and 26 CFR 56.4911-2(c)(1)-(c)(3).

congress, legislative body or a subdivision, or a cognizant staff member thereof, provided such information is readily obtainable and can be readily put in deliverable form, and further provided that costs under this section for travel, lodging or meals are unallowable unless incurred to offer testimony at a regularly scheduled Congressional hearing pursuant to a written request for such presentation made by the Chairman or Ranking Member of the Committee or Subcommittee conducting such hearings;

(ii) Any lobbying made unallowable by paragraph (c)(1)(iii) of this section to influence state legislation in order to directly reduce the cost, or to avoid

impairment of the non-Federal entity's authority to perform the grant, contract or other agreement; or

(iii) Any activity specifically authorized by statute to be undertaken with funds from the Federal award.

(iv) Any activity, excepted from the definition of "lobbying" or "influencing legislation" by the Internal Revenue Code provisions that require nonprofit organizations to limit their

participation in direct and "grass roots" lobbying activities in order to retain their charitable deduction status and avoid alternative excise taxes, IRC secs. 501(c)(3), 501(h), 4911(c), and 4911(d);

(v) Nonpartisan analysis, study, or research reports;

(vi) Examinations and discussions of broad social, economic, and similar problems; and

(vii) Information provided upon request by a legislator for technical advice and assistance, as defined by IRC sec. 4911(d)(2) and 26 CFR 56.4911-2(c)(1)-(c)(3).

(viii) When a non-Federal entity seeks reimbursement for indirect (F&A) costs, total lobbying costs must be separately identified in the indirect (F&A) cost rate proposal, and thereafter treated as other

RECOMMENDATIONS

COMPLIANCE

MANAGEMENT

REQUIREMENTS

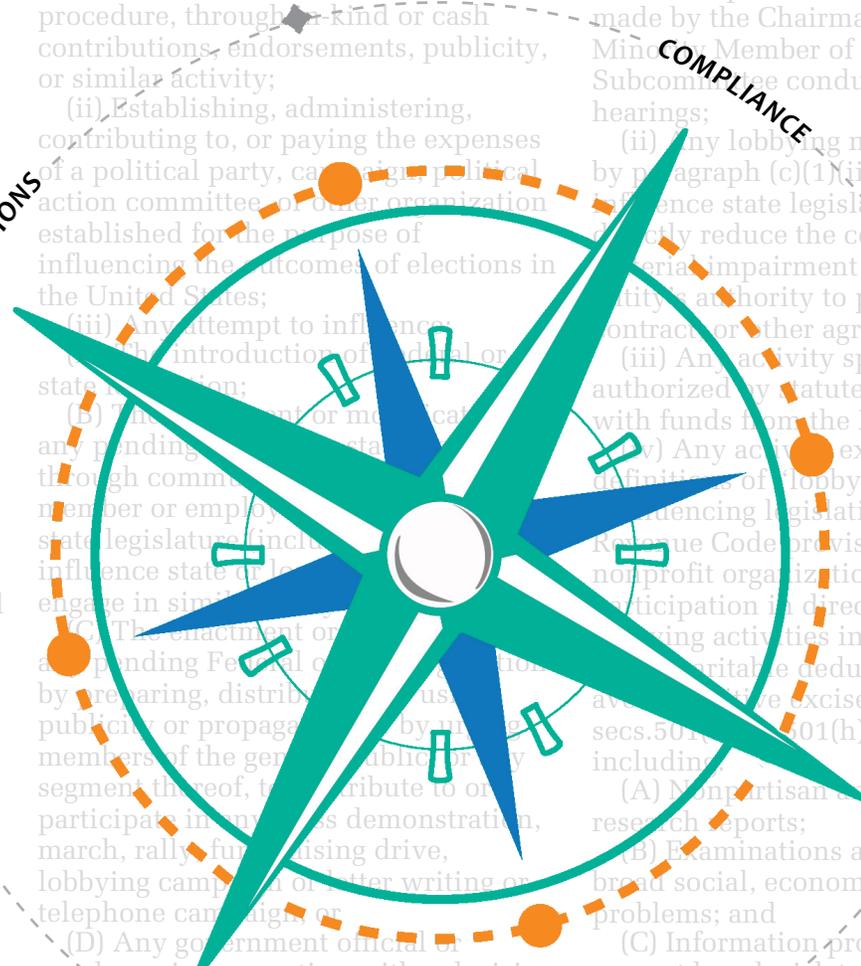


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Introduction

The legal framework that governs both public and nonprofit Community Action Agencies (CAAs) as recipients of federal grant funds is vast. This Guide attempts to give leaders of CAAs – the board and the executive management – an overview of some of the legal requirements that they will work with on a regular basis. Even though this is an extensive Guide, it is not intended to address every legal requirement that public and nonprofit CAAs face. The intent is to equip CAA leaders with the information they need to either make more informed decisions or recognize the instances when they may need additional information. This Guide is also intended to help CAA leaders work more effectively with outside attorneys who advise the organization on legal and compliance matters.

The Guide is divided into four main chapters: (i) general overview of federal grant law; (ii) the Community Services Block Grant Act; (iii) financial management of federal grants; and (iv) general tax-exempt organization requirements. Each chapter has its own table of contents that lays out in greater detail the specific topics covered. Throughout the Guide we reference Community Action resources as well as other resources that CAAs may refer to for additional information about the topics discussed. Also, Community Action Program Legal Services, Inc. (CAPLAW) and the national Community Action Partnership (Partnership), as training and technical assistance providers for the Community Action network, are always available to provide additional guidance and assistance regarding the concepts addressed throughout this Guide.

This Guide contains many legal citations, both in the text and in each chapter's endnotes. We encourage readers to use the citations to find and review the source laws discussed in each chapter. These laws may be found by simply typing the citation into an internet search engine. A search often returns results that include official government websites that compile laws along with third-party websites that host legal information. Government websites are usually the most reliable and accurate providers of source laws.





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Chapter One: General Overview of Federal Grant Law

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Chapter One

General Overview of Federal Grant Law

A. Introduction

Because federal grants represent a major source of funding for CAAs, it is important for CAA leaders to have a working knowledge of federal grant law. To properly perform the requirements of a federal grant award, members of the board of directors and the management team should, at a minimum, be familiar with the basic aspects of their organization's grant life cycle, the legal authority underlying their federal grants and the process for enforcement actions and appeals.

B. Legal Authority for Federal Grants

CAAs typically receive federal grants from a number of federal awarding agencies. For example, the U.S. Department of Health and Human Services (HHS) administers CSBG funds, Low Income Home Energy Assistance Program (LIHEAP) funds as well as Head Start funds, while the U.S. Department of Energy administers funding for its Weatherization Assistance Program (WAP) and the U.S. Department of Housing and Urban Development (HUD) administers funds for a multitude of programs addressing homelessness and housing for income-eligible individuals and families.

Federal Laws and Regulations

Federal awarding agencies have no inherent power to award grants or other assistance. All grants must be authorized by enabling legislation passed by Congress and must specifically give the federal funding source the power to award financial assistance.

At the federal level, there are a number of federal statutes that affect federal grant awards, including appropriations statutes, cross-cutting provisions, and the federal Administrative Procedure Act (APA).¹

...the APA governs procedures for creating regulations, such as the notice-and-comment process, as well as enforcement actions.

Appropriations statutes, which are passed by Congress to fund authorized federal programs, not only specify the amount appropriated for specific programs but also may include substantive provisions concerning such programs. Certain "cross-cutting" provisions are also incorporated into many federal programs. Common cross-cutting provisions include anti-discrimination requirements, the Byrd Amendment (a law restricting lobbying the federal

government regarding grants) and the Federal Funding Accountability and Transparency Act (a law requiring recipients of certain federal grants and cooperative agreements to report executive compensation and subaward information) and rules on suspension and debarment from receiving federal awards. In addition, the APA governs procedures for creating regulations, such as the notice-and-comment process, as well as enforcement actions.



Federal grants are also governed by program-specific regulations, federal administrative requirements and cost principles, and individual funding source guidance. Federal awarding agencies may issue implementing regulations to carry out the authorized program through the notice-and-comment process. Federal awarding agencies may also provide less authoritative guidance to grantees in the form of Information Memoranda (IM) or program instructions or may have general grants policies (such as the HHS Grants Policy Directives) that guide grants administration.

In addition, federal agencies that make federal awards to non-federal entities, such as states or CAAs, as well as non-federal entities that receive federal grant funds are generally subject to the Office of Management and Budget (OMB)'s Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance). The Uniform Guidance, intended to be a government-wide framework for grants management, synthesized and superseded guidance from earlier OMB circulars. The Uniform Guidance is generally codified at 2 Code of Federal Regulations (C.F.R.) Part 200 and also has been adopted and codified by individual federal agencies. A federal agency's "codification" of the Uniform Guidance simply means that the federal agency placed, or codified, its own version of the Uniform Guidance in a separate location in the C.F.R. For example, HHS's codification of the Uniform Guidance is at 45 C.F.R. Part 75. Federal agency codifications mostly reference the Uniform Guidance codified at 2 C.F.R. Part 200, with a few program-specific tweaks. However, HHS's adoption of the Uniform Guidance completely re-codified the Uniform Guidance and also included revisions specific to HHS programs. New funding issued by federal awarding agencies on or after December 26, 2014 is subject to the Uniform Guidance rules.

State Laws and Regulations

State law may also be relevant to federal grants, particularly block grants, which are administered by states and generally provide the state with considerable discretion and flexibility in grant-making and grant-management. A state may have program-specific statutes or regulations. Like the federal funding source, the state may provide less authoritative guidance in the form of specific program instructions or manuals or general administrative policies. In addition, the state's own Administrative Procedure Act will address questions concerning the validity of state rulemaking and enforcement actions.

Award Terms and Conditions

The award agreement provides the most specific terms and conditions governing the performance of the grant by the grantee. The agreement generally addresses the scope of work, cross-cutting requirements, monitoring and reporting, payment methods (advances versus reimbursement), performance goals, access to records, and enforcement actions. Note, however, that where the terms of the award contradict applicable statutory and regulatory provisions, the statute and regulations will govern.

C. Types of Federal Awards and the Award Funding Process

Types of Award Instruments

Most federal awards that CAAs receive are in the form of federal grants rather than cooperative agreements or federal procurement contracts. However, because the rights and obligations of the award as well as the underlying legal authority differ depending on the type of funding in question, CAAs must understand the differences between **grants** and the other two primary types of federal awards, **procurement contracts** and **cooperative agreements**. The Federal Grant and Cooperative Agreement Act² clarifies the differences among funding instruments based on their principal purpose, differentiates procurement awards from assistance awards, defines grants and cooperative agreements, and directs Federal agencies to use whichever instrument is appropriate for the relationship contemplated by the statute authorizing the grant program.

In Detail

Grant

A grant is the vehicle used to award funds to support the recipient's own activity, which generally serves a public purpose such as low-income housing or education, without substantial involvement from the awarding agency. A grant must be authorized by federal statute and is governed by that statute, federal regulations, and the terms and conditions of the award. Although federal grants are a type of contract, they differ from procurement contracts. Unlike with a procurement contract, the grant's funding source and the grantee do not have free rein to negotiate the grant's terms and conditions because the grant terms must be consistent with the authorizing statute.

Cooperative Agreement

A cooperative agreement, like a grant, is a vehicle used to award funds to support the recipient's own activity. A cooperative agreement is used instead of a grant if the federal awarding agency is expected to be substantially involved in the activity. "Substantial involvement" generally means the federal awarding agency will collaborate or participate in the management of the project, as opposed to simply approving the grantee's plans before the award or exercising normal federal stewardship responsibilities during the award period.³

Procurement Contract

A procurement contract is the vehicle used to buy property or services from a non-federal entity for the federal government's own use, such as an agreement for a food services company to operate a federal employee cafeteria. A procurement contract generally is not authorized by a specific federal statute and will be governed by federal acquisition regulations and the individual contract terms.

Types of Federal Grants

There are two main categories of federal grants: **mandatory grants** and **discretionary grants**. Each type of grant is characterized by a specific set of terms that governs the relationship between the awarding agency and the grantee. CAAs typically receive various types of federal grants within these two categories.

In Detail

Mandatory grants

Mandatory grants are those that recipients do not compete for and which an awarding agency must make if a grantee (usually a state) meets the requirements set forth in the authorizing statute and regulations. A state seeking a mandatory grant, however, must submit a state plan to the federal agency administering the program detailing how it will use the grant funds. The state plan

must include assurances that the state will comply with applicable statutory and regulatory requirements of the grant, and the state must follow the state plan once it has been approved by the federal awarding agency. States often further subgrant or subcontract their mandatory grant funds to other entities, such as CAAs, to operate programs or provide services with the grant funds.

Mandatory grants are further subdivided into three categories: entitlement grants, formula grants and block grants. “Entitlement grants,” such as Medicaid, are those where the ultimate beneficiary is entitled to receive aid upon demonstrating that he or she qualifies for assistance. Amounts awarded under “formula grants,” such as WAP, are calculated by a formula set out in the authorizing statute which may take into account factors such as population, census data, and the annual appropriation provided by Congress. Formula grants are subject to a number of federal cross-cutting requirements, including the Uniform Guidance. If a state awards the funds to a subrecipient, such as a CAA, the subrecipient will also be subject to the same cross-cutting requirements. Finally, as with formula grants, funding amounts for “block grants,” such as CSBG, are determined by a formula under the authorizing statute. Unlike formula grants, however, application of the Uniform Guidance to block grants is limited to:

- The acronyms and definitions in Subpart A;
- The general provisions in Subpart B;
- The public notice of federal financial assistance programs requirement in Section 200.202 in Subpart C;
- Rules on distinguishing between subrecipients and contractors, pass-through entity requirements, and fixed amount subawards in Sections 200.330 – 200.332 of Subpart D;⁴ and
- Single audit requirements in Subpart F.

Unless the federal authorizing statute for the block grant requires compliance with additional sections/subparts and/or a state chooses to voluntarily incorporate by reference additional sections/subparts in its state rules and/or grant agreements, the above Uniform Guidance provisions are all that will apply to a block grant.

For example, the Uniform Guidance has interpreted the “cost and accounting standards” language in the federal CSBG act to mean that the cost principles of the Uniform Guidance (Subpart E) apply to CSBG grant recipients.⁵ Thus, with respect to its CSBG funds, a CAA must comply with the federal cost principles (Subpart E of the Uniform Guidance) in addition to the Uniform Guidance provisions listed above that normally apply to all block grants. If the state wants its CAAs to comply with the remainder of the uniform administrative requirements in Subpart D with respect to its CSBG funds, it may do so by incorporating those standards by reference in the CSBG agreement with the CAA and/or in the state CSBG statutes and regulations, if any exist.

Discretionary grants

Discretionary grants, also known as direct, categorical, or project grants, are awarded by a federal agency directly to an eligible recipient that applied for the grant, such as a CAA, rather than through a state. Discretionary grants are usually made through a competitive grant process and are for a specific, time-limited project. The awarding agency generally has discretion to select the grantee and to determine how much it will receive. Federal awarding agencies can also attach program or

project-specific conditions to the grant. Recipients of discretionary grants are subject to the cross-cutting requirements discussed above, including the Uniform Guidance. Funding under the Head Start Act is an example of a discretionary grant that many CAAs receive.

Federal Grant Funding Process

Federal awards must go through the process of **authorization**, **appropriations**, and **apportionment** before they are paid out of the U.S. Treasury to grant recipients.

In Detail

Authorization

In general, Congress must authorize spending on federal programs, including grant programs, through separate authorizing (or enabling) legislation that creates a program and defines its scope. Historically, Congress also authorized spending through “earmarking,” or setting aside amounts to be awarded to recipients named or described in the appropriations legislation or committee report.

Appropriations

After Congress passes legislation authorizing a particular grant program, the program must be funded through the annual appropriations process in which Congress passes an appropriations statute specifying the amount of federal funds to be spent on the program and permitting a federal agency to incur obligations and to make payments for the program out of the U.S. Treasury. Appropriated funds may be obligated and spent only for the purposes specified in the authorizing legislation, unless the legislation provides otherwise. Where the appropriations legislation specifies that funds are available for a definite period of time, those funds may only be used for expenses that are properly incurred during that period. Federal awarding agencies cannot spend or obligate more funds than Congress has appropriated for a particular program and cannot spend funds before the funds have been appropriated.

Apportionment

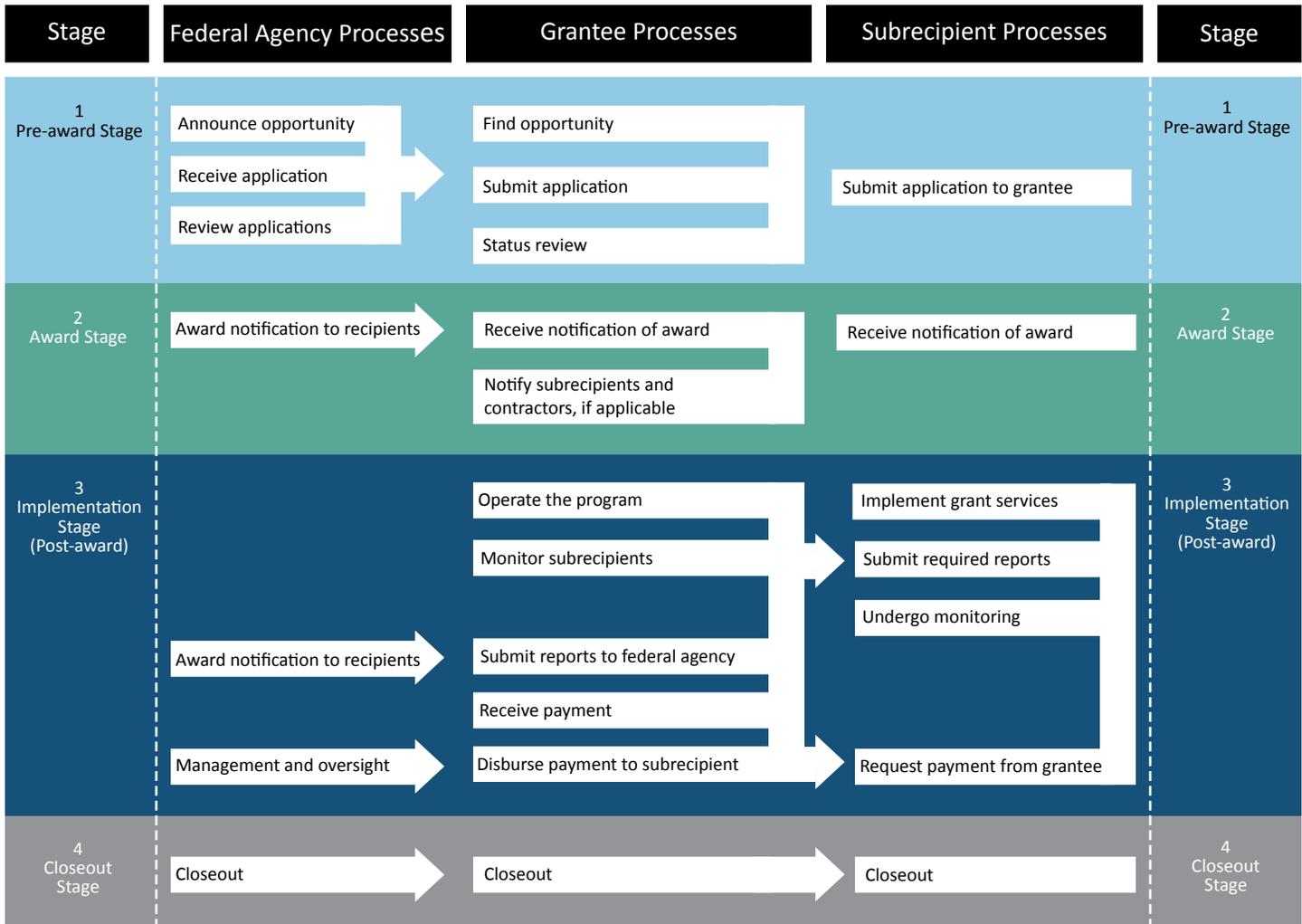
To prevent federal awarding agencies from using all of their appropriated funds at the beginning of the funding period, the federal Anti-Deficiency Act⁶ requires that appropriations be spread out over the period during which they are available. Before the Anti-Deficiency Act was passed, federal awarding agencies would often intentionally run out of money by committing their entire budget in the first few months of the funding period, forcing Congress to pass additional appropriations to maintain the agency’s operations during the rest of the funding period. Thus, under the Anti-Deficiency Act, the OMB may choose to apportion an agency’s funds over the course of the federal fiscal year. Federal awarding agencies are not allowed to spend the funds or create or authorize an obligation under the funds in excess of the amount apportioned for that period.

Federal Grant Opportunities

CAAs may stay informed of federal funding opportunities by periodically checking Grants.gov (www.grants.gov), a centralized website created to standardize and streamline the grant application process pursuant to the federal Financial Assistance Management Improvement Act of 1999. All federal agencies are required to post grant opportunities and allow for online application submissions at Grants.gov. The Catalog of Federal Domestic Assistance (www.cfda.gov) also lists all programs available to non-federal entities, including local government and non-profit entities.

D. Grant Life Cycle

Although there are variations in the specific requirements of each component of the life cycle for different types of grants or recipients, the life cycle of a federal grant generally includes the following:



E. Subrecipient and Contractor Determinations

CAAs often enter into agreements involving the spending of their federal funds in such a way as to create either a “subrecipient” or a “contractor” relationship. A CAA selecting a contractor must follow procurement procedures in making its selection. However, a CAA selecting a subrecipient does not need to follow procurement procedures but must instead evaluate the potential subrecipient’s risk of noncompliance with federal grant rules. Under the Uniform Guidance, CAAs are subject to certain reporting and monitoring requirements with respect to their subrecipients. While a subrecipient generally must comply with the same requirements as the grantee, including compliance with the Uniform Guidance, a contractor providing goods or services under a procurement contract is usually not subject to these requirements. Thus, determining whether a relationship involves a subrecipient under a subaward or a contractor under a procurement contract for goods or services will affect the terms and conditions of the agreement as well as the CAA’s



responsibilities to oversee the relationship. Pass-through entities such as states and individual CAAs must evaluate each agreement on a case-by-case basis to determine whether the party receiving the funds acts in the role of a subrecipient or a contractor. The substance of the relationship is determinative, and pass-through entities should use judgment in classifying each agreement as a subaward or procurement contract, as not all characteristics listed below will be present in every relationship.⁷

Subrecipient Characteristics

A “subrecipient” is an entity that receives a subaward from a pass-through entity to carry out part of a federal program, but does not include an individual that is a beneficiary of such program.

Factors suggesting that an entity is a subrecipient:	
✓	the entity determines who is eligible to receive what federal assistance;
✓	the entity’s performance is measured in relation to whether objectives of a federal program were met;
✓	the entity has responsibility for programmatic decision making;
✓	the entity is responsible for adherence to applicable federal program requirements specified in the federal award; and
✓	in accordance with its agreement, the entity uses the federal funds to carry out a program for a public purpose specified in authorizing statute, as opposed to providing goods or services for the benefit of the pass-through entity. ⁸

Examples of subrecipients include: (i) a Head Start delegate agency that provides comprehensive Head Start child care programs to children in specific geographic areas; and (ii) a Title X family planning delegate agency that operates a community health center providing a full range of Title X family planning services in specific neighborhoods.

Contractor Characteristics

A “contractor,” on the other hand, is an entity that has an agreement to provide a non-federal entity with property or services needed to carry out a project or program under a federal award.

Factors suggesting that an entity is a contractor for goods or services:

✓	the entity provides the goods and services within normal business operations;
✓	the entity provides similar goods or services to many different purchasers;
✓	the entity normally operates in a competitive environment;
✓	the entity provides goods or services that are ancillary to the operation of the federal program; and
✓	the entity is not subject to compliance requirements of the federal program as a result of the agreement, though similar requirements may apply for other reasons. ⁹

Common examples of contractors are entities providing design and maintenance services for a CAA’s website, Head Start food service, or training for the CAA’s employees.

Subrecipient Oversight

Grantees and pass-through entities are required to monitor the activities of their subrecipients to ensure that subawards are used for authorized purposes and in compliance with applicable federal law and the terms and conditions of the subawards.¹⁰ To determine the appropriate level of subrecipient monitoring, the pass-through entity must first evaluate each subrecipient’s risk of noncompliance with federal statutes, regulations, and the terms and conditions of the subaward.¹¹ In doing so, the pass-through entity will need to consider factors such as: (i) the subrecipient’s prior experience with the same or similar subawards; (ii) the results of previous audits; (iii) whether the subrecipient has new personnel or new or substantially changed systems; and (iv) if the subrecipient receives direct federal awards, the extent and results of the federal awarding agency’s monitoring process.

At a minimum, all pass-through entities are required to conduct the following monitoring activities: (i) review financial and performance reports required by the pass-through entity; (ii) verify that an audit or other on-site review is being performed pursuant to the Uniform Guidance and, if the subrecipient expects to expend \$750,000 or more in federal awards during its fiscal year, the federal Single Audit Act; (iii) follow up to ensure that the subrecipient takes appropriate action on any audit findings and deficiencies; and (iv) issue a management decision on audit findings relating to the federal funds awarded to the subrecipient by the pass-through entity.¹²

Depending on the results of the initial risk assessment, pass-through entities may also need to provide subrecipients with on-site training and technical assistance on program-related matters, perform on-site reviews of the subrecipient’s program operations or arrange for agreed-upon procedures to monitor the subrecipient.¹³

Subrecipient Agreements

The pass-through entity is solely accountable to its funding source for all activities conducted by, and funds

provided to, the subrecipient. Thus, CAAs working with subrecipients should ensure that the subaward agreement covers all of the requirements binding upon a subrecipient and allows the CAA to properly monitor and oversee the subrecipient's activities.

To prepare a subaward agreement, a CAA should start with the grant award or grant agreement from the original funding source and carefully review all programmatic, administrative, and financial requirements, including attachments, proposals, and any other items incorporated. The CAA should also review all statutes, regulations, policies, and other authority cited in the grant award or agreement. After reviewing the original award or agreement and the cited authority, the CAA should confirm that it fully understands the scope of activities to be performed by the subrecipient. The CAA should then review the subaward proposal and discuss any questions about it with either the author of the proposal or with the appropriate programmatic personnel. If the original grant contains performance measures or goals, the CAA should explain how it expects the subrecipient to contribute to meeting those goals. The subaward agreement should clearly allocate responsibilities between the CAA and the subrecipient. The CAA and the subrecipient should then discuss possible compensation methods (e.g., cost reimbursement or advancement of funds based on projected costs, or a combination of the methods) and select the most appropriate method. The CAA should require a sufficient level of supporting documentation for payments and require the subrecipient to develop and attach an adequately detailed budget to the subaward agreement.

PRACTICE TIPS

Key Terms for Subaward Agreements

- Statement and scope of work;
- Clear identification of the grant as a subaward;
- Terms for the payment and allocation of funds;
- Provisions for suspension and termination with or without cause, including descriptions of the conduct permitting the CAA to suspend and/or terminate the subaward with cause;
- Requirements of the Uniform Guidance imposed on the subrecipient;
- Information required pursuant to the Uniform Guidance, Section 200.331(a), such as federal award identification data, federally negotiated indirect cost rate (FNICR) if subrecipient has one, de minimis rate or rate negotiated between CAA and subrecipient if no FNICR exists, access to records and financial statements, and closeout conditions;
- Reporting and recordkeeping requirements for the subrecipient;
- Terms regarding general access to and confidentiality of records; and
- Provisions for compliance with all other governing laws, regulations, and the original grant agreement terms.

official submission, the Byrd Amendment¹⁷ prohibits using federal funds to attempt to influence federal employees in connection with the awarding of federal grants. CAAs must submit a certification form when applying for federal grants regarding compliance with the Byrd Amendment.¹⁸ Moreover, neither nonprofit nor public CAAs may use program income or federal matching funds to lobby.

Narrow Exceptions for Federal Funds

Certain activities related to influencing legislation may fall within one or more narrow exceptions to the prohibition against using federal funds set forth in the Uniform Guidance and discussed below.¹⁹ Note, however, that recent federal appropriations statutes that have prohibited federal grant recipients from using federal funds to engage in lobbying activities, have not incorporated the exceptions under the Uniform Guidance.²⁰ A federal appropriations statute will trump the Uniform Guidance. Thus, for example, where the HHS appropriations statute for a particular year prohibits using HHS funds to lobby and does not include the exceptions contained in the Uniform Guidance, CAAs must follow the HHS prohibition with respect to their HHS funds (e.g., CSBG, Head Start, and LIHEAP). The Uniform Guidance exceptions are as follows:

- **Lobbying activities related only to local legislation**, rather than state or federal legislation, do not appear to be subject to the general prohibition in the Uniform Guidance on using federal funds to lobby.
- **Providing technical and factual presentations of information** on topics directly related to the performance of a grant, contract, or other agreement through hearing testimony, statements, or letters in response to a documented request from Congress, a state legislature, or any such subdivision, member, or staff; provided that such information must be readily obtainable and can be readily be put into deliverable form. However, costs for travel, lodging, or meals are unallowable unless incurred to offer testimony at a regularly-scheduled Congressional hearing by written request from the chairman or ranking minority member of the committee or subcommittee conducting the hearings. Note that this exception only covers written or oral testimony in response to a documented request and does not cover phone calls or meetings.
- **Lobbying to influence state legislation to directly reduce the cost or avoid material impairment** of the CAA's authority to perform its grants, contracts or other agreements. It is important to note that this "self-defense" exception is generally narrowly construed. The IRS rules on lobbying restrictions have a similar self-defense exception, but the examples contained in the IRS regulation specifically note that lobbying on appropriations acts would not trigger the self-defense exception.
- **Engaging in any activity specifically authorized by statute** to be undertaken with funds from the federal award.
- **Any activity excepted from the definitions of "lobbying" or "influencing legislation" by the provisions in the IRS regulations**, such as: (i) nonpartisan analysis, study, or research reports;



(ii) examinations and discussions of broad social, economic, and similar problems, so long as such activities are not directly addressed to specific legislation being considered nor directly encourage recipients to take action on legislation; and (iii) technical advice or assistance to a governmental body, committee, or other subdivision in response to their written request.²¹

Lobbying by CAAs

CAAs can lobby - they just cannot use any resources paid out of federal funds, including staff time, supplies, equipment, postage, or space for lobbying activities. Moreover, CAAs may not use program income or federal matching funds to lobby. Nonprofit CAAs must also comply with 501(c)(3) tax rules discussed in *Section D. Lobbying* in *Chapter Four: General Tax-Exempt Organization Requirements* and public CAAs must comply with local laws.

PRACTICE TIPS

When Conducting Lobbying Activities

Use non-federal, unrestricted funds to lobby. CAAs should only use non-federal, unrestricted funds for any expenditures made in relation to lobbying activities. Any staff member who is primarily responsible for lobbying should be paid, in part or in whole, out of the CAA's non-federal, unrestricted funds. If a staff member only spends a limited amount of time at work engaged in lobbying, the CAA should pay that portion of the staff member's salary using non-federal, unrestricted funds.

Track time spent by employees lobbying. CAAs should track employee lobbying time on a time card on an ongoing basis or as an "exception report" when the employee engages in lobbying activities. The CAA may need to show a funding source that any time spent lobbying was paid out of unrestricted, non-federal funds.

Do not include lobbying costs as part of the indirect cost pool. If a CAA has a federally negotiated indirect cost rate, lobbying costs must be separately identified as direct costs in the CAA's indirect cost rate proposal.

Lobby on personal time, without using CAA resources. Employees are free to lobby on their personal time without using any CAA resources.

Be careful when asking non-exempt employees to volunteer to lobby. CAAs should be aware that they must pay employees who are not exempt from overtime pay under the federal Fair Labor Standards Act for their volunteer lobbying efforts if (i) they are asked or required to lobby or (ii) if the lobbying relates to their paid job. Failure to do so may result in wage and hour law violations.

Lobby using board members or other volunteers. CAAs may typically use board members or other volunteers to lobby. However, as discussed in *Section D. Lobbying* in *Chapter Four: General Tax-Exempt Organization Requirements*, with respect to nonprofit CAAs, volunteer time is used in certain circumstances to determine if a 501(c)(3) tax-exempt organization has engaged in a prohibited amount of lobbying. Also, local laws may restrict the lobbying that may be conducted by volunteers on behalf of a public CAA.

G. Political Campaign Activities

Because both public and nonprofit CAAs receive federal funding, they are subject to various restrictions with respect to engaging in political campaign activities under (i) some authorizing statutes for federal awards, (ii) the federal appropriations act funding the federal awards, (iii) the cost principles in the Uniform Guidance, and (iv) the federal award terms and conditions. Moreover, for nonprofit CAAs, the IRS regulations governing 501(c)(3) tax exempt organizations set forth restrictions that govern a nonprofit CAA's ability to engage in political campaign activities. For a public CAA, local laws and ordinances may impose additional restrictions regarding its ability to engage in political campaign activities.

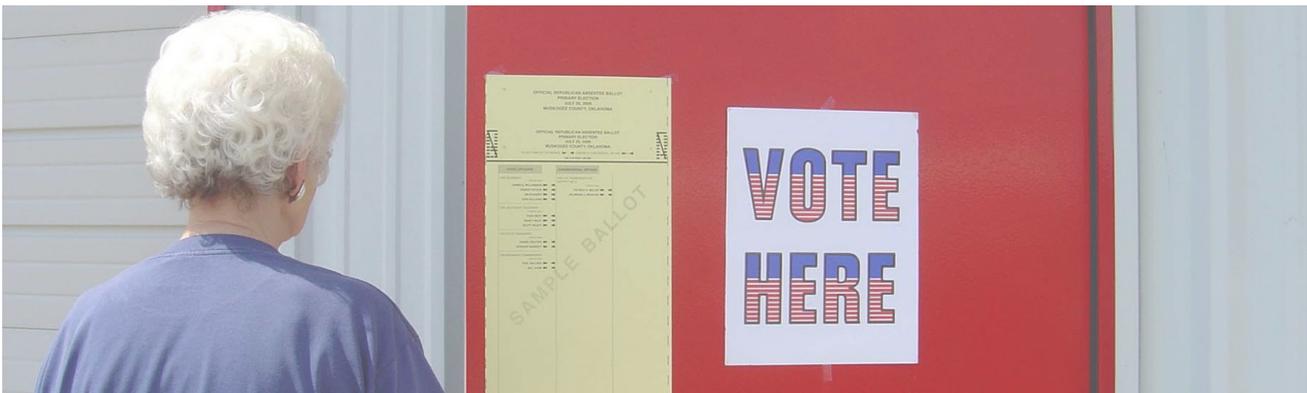
NOTE

This section on political campaign activity restrictions applies to both public and nonprofit CAAs as recipients of federal grant funds. A nonprofit CAA should also refer to *Section E. Political Campaign Activities* in *Chapter Four: General Tax-Exempt Organization Requirements* for a discussion of the political campaign activity restrictions that apply to it as a 501(c)(3) tax-exempt organization. A public CAA should consult with an attorney for its local government to determine what other requirements may restrict its ability to engage in political campaign activities.

CSBG and Head Start Act Restrictions

Organizations receiving CSBG and/or Head Start funding are limited in their ability to engage in political campaign activity. Under the CSBG Act,²² public and nonprofit CAAs may **not** carry on programs involving the use of CSBG program funds, providing services, or employing or assigning personnel in a manner supporting or resulting in the CSBG program being identified with: (i) any partisan or nonpartisan political activity, including any political activity associated with a candidate or group in an election for public or party office; (ii) any activity to provide transportation to the polls or similar assistance; or (iii) voter registration activities.²³ In OCS [IM 81](#), the federal Office of Community Services, the federal agency that administers CSBG, reiterates that CAAs and other entities receiving CSBG funding cannot conduct CSBG-funded programs or provide CSBG-funded services in a manner that could result in the identification of such programs or services with prohibited political activities.

Similarly, the Head Start Act²⁴ prohibits individuals employed by or otherwise assigned to Head Start programs from, during work hours: (i) engaging in any partisan or nonpartisan political activity, including any political activity associated with a candidate or group in an election for public or party office; or (ii) providing transportation to the polls or similar assistance.²⁵ Further, Head Start funds and resources may not be used to conduct voter registration activities. However, Head Start grantees may permit nonpartisan entities to conduct voter registration at Head Start-funded facilities during normal hours of operation.



The cost principles of the Uniform Guidance, which apply to both CSBG and Head Start funds, specifically prohibit CAAs from using federal funds to contribute to political parties, campaigns, or political action committees (PACs).²⁶

Hatch Act Restrictions

The Hatch Act typically only restricts the political activity of individuals who are principally employed by states or local executive agencies and who work in connection with programs financed in whole or in part by federal loans or grants. However, the Hatch Act applies to both public and nonprofit CAAs because it is incorporated by reference into the CSBG and Head Start Acts. To date, they are the only federal grant statutes to do so. *All of the Hatch Act restrictions discussed below apply regardless of whether the restricted activity is conducted during work time or on the employee's personal time, even if the employee is on paid or unpaid leave.*

Application of Hatch Act to Employees of Nonprofit CAAs

Two types of employees of nonprofit CAAs are subject to restrictions under the Hatch Act (Hatched Employees). The **FIRST TYPE** of employee restricted by the Hatch Act is one who:

- either (i) spends more than half of his/her total work time employed by a CAA or Head Start grantee or (ii) receives more than half of his/her total wages from the CAA or Head Start grantee; and
- works in connection with activities financed by CSBG and/or Head Start funds.²⁷

For example, an employee who is employed full-time for a nonprofit CAA but works solely for the CAA's weatherization program fully funded by U.S. Department of Energy grants would not be covered by the Hatch Act.

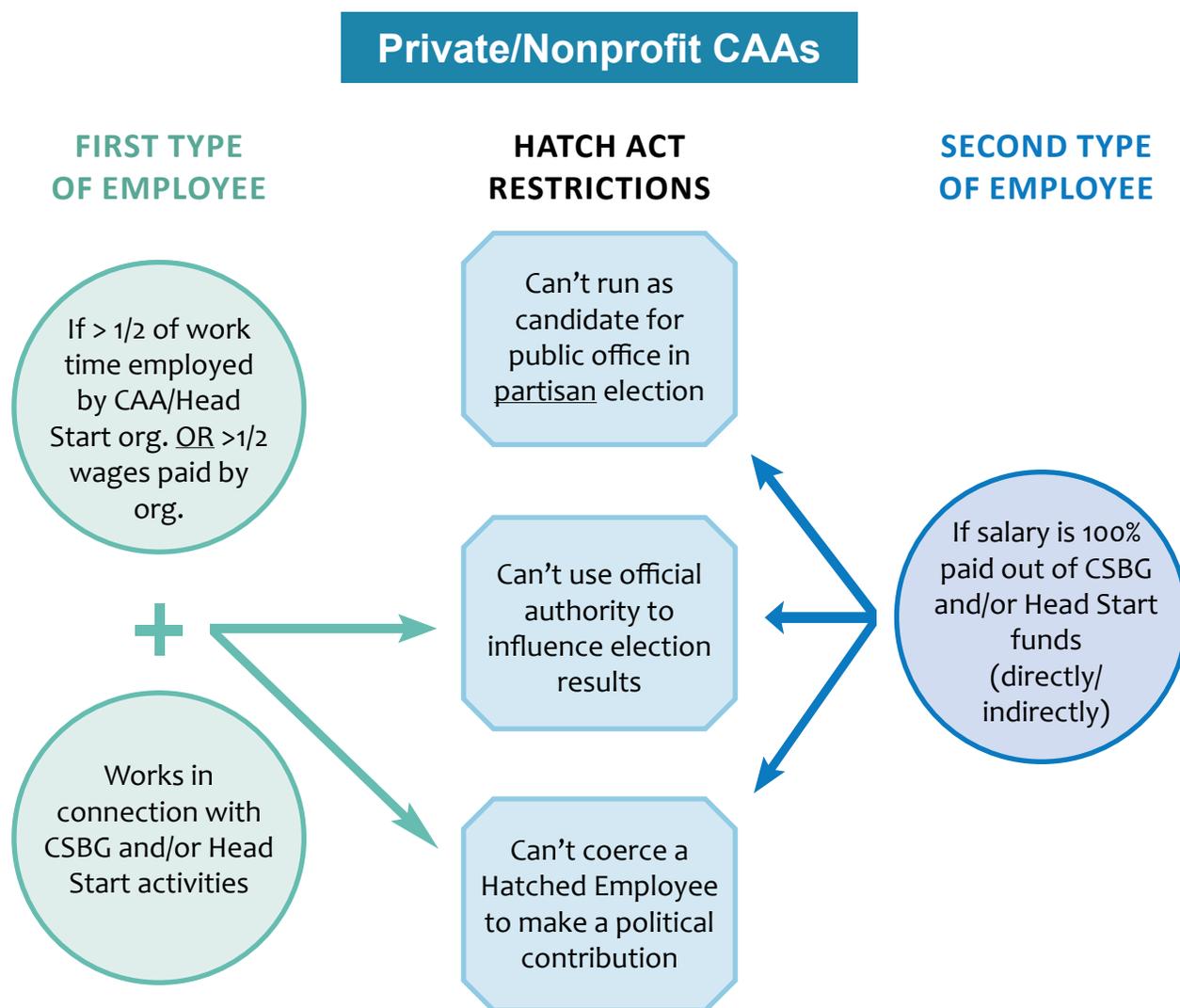
This first type of employee is subject to the following two restrictions:

- He/she may not use his/her official authority to influence or interfere with or affect the results of an election or nomination for office; and
- He/she may not directly or indirectly coerce, attempt to coerce, command, or advise another employee covered under the Hatch Act to make political contributions to candidates, PACs, or political parties.²⁸ Supervisors who ask for political contributions from their subordinates are deemed to have indirectly engaged in coercion.

The **SECOND TYPE** of employee who is restricted under the Hatch Act is one whose salary is paid entirely out of CSBG or Head Start funds or entirely out of a combination of CSBG and Head Start funds. In addition to being subject to the restrictions above that apply to the first type of employee,²⁹ this second type of employee also may not be a candidate for public office in a partisan election.³⁰ Generally speaking, "partisan" elections are those in which at least one candidate is nominated by, represents, is supported by, or associates himself or herself with a party whose Presidential candidate received votes in the last election, or if any of the candidates are identified on the ballot with a political party.³¹ Elections are also deemed to be "partisan" for the purposes of Hatch Act if state or local laws designate them as such.

All of the Hatch Act restrictions...apply... during work time or on the employee's personal time...

This graphic helps to illustrate the two types of employees and the applicable restrictions:

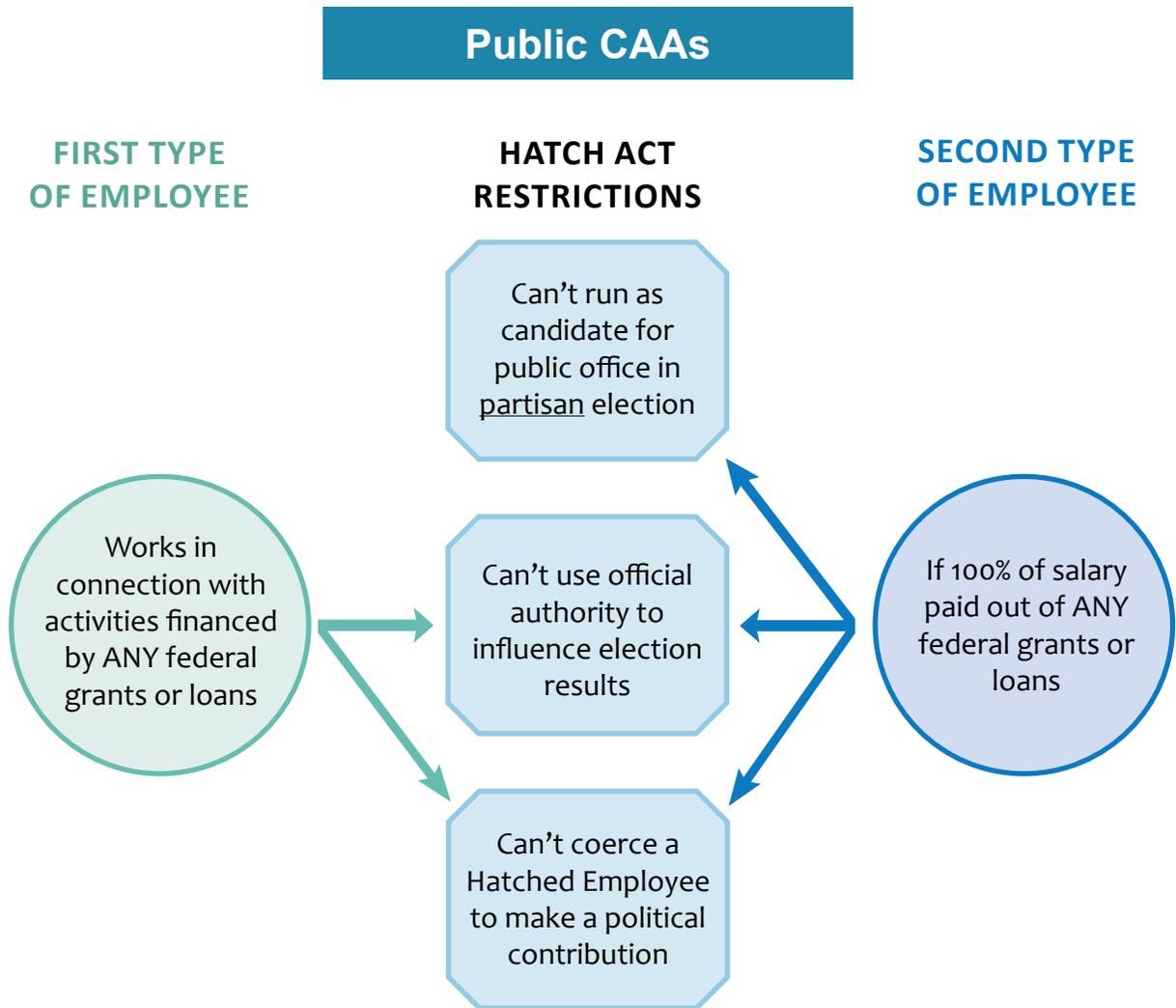


Application of Hatch Act to Employees of Public CAAs

Two types of employees of public CAAs are also subject to restrictions under the Hatch Act (Hatched Employees). For the **FIRST TYPE** of employee, the application of the Hatch Act is broader than the application to nonprofit CAA employees. The application is not limited to those employees who work in connection with activities financed by CSBG or Head Start funds. Instead, every public CAA employee who works in connection with activities financed in whole or in part by any federal grant or loan is subject to the Hatch Act³² and may not (i) use his or her official authority to influence or interfere with or affect the results of an election or nomination for office, or (ii) directly or indirectly coerce, attempt to coerce, command, or advise another employee covered under the Hatch Act to make political contributions to candidates, PACs, or political parties.³³ The **SECOND TYPE** of employee restricted under the Hatch Act is a public CAA employee whose salary is paid completely, directly or indirectly, by federal loans or grants (not just CSBG or Head Start grants). This second type of employee may not be a candidate for public office in a partisan election.³⁴ Generally speaking, “partisan” elections are those in which at least one candidate is nominated by, represents, is supported by, or associates himself or herself with a party whose Presidential candidate received votes in

last election, or if any of the candidates are identified on the ballot with a political party.³⁵ Elections are also deemed to be “partisan” for the purposes of Hatch Act if state or local laws designate them as such.

This graphic helps to illustrate the two types of employees and the applicable restrictions:



Activities by Employees of both Public and Nonprofit CAAs Not Subject to Hatch Act

It is important to note that both nonprofit and public CAA employees subject to the Hatch Act may, on their own time and outside of the workplace, (i) run for office in a nonpartisan election,³⁶ (ii) continue to serve in the offices to which they were elected prior to becoming subject to Hatch Act restrictions,³⁷ (iii) run for and hold office in a political party,³⁸ and (iv) participate in political campaigns, party organizations, and make contributions.³⁹

Penalties

If a federal awarding agency has reason to believe that an employee covered by the Hatch Act has violated the prohibited activities under the Hatch Act, it must report the matter to the U.S. Office of Special Counsel



(OSC), the federal agency responsible for investigating and prosecuting Hatch Act violations.⁴⁰ The OSC will investigate the report and both the employee and the CAA are entitled to a hearing before the Merit Systems Protection Board, which will make a final decision.⁴¹ If the Merit Systems Protection Board determines that a Hatch Act violation exists, it may require the organization to forfeit its federal funding in an amount equal to two years of the employee's salary at the time of the Hatch Act violation. In determining the seriousness of the offense, the OSC looks at the extent to which an employee knowingly violated the statute and whether the employee had received a warning from OSC or the CAA's funding source prior to the violation.

H. Post-Award Agency Enforcement Actions and Grantee Rights

During the grantee's performance of the award, the federal awarding agency will perform periodic monitoring and reporting that may, at times, lead to the agency taking enforcement action against the grantee for failure to comply with applicable laws, regulations, or the award's terms and conditions. Grantees facing an enforcement action sometimes fail to appreciate the significance of the action and its consequences. This often results from a misunderstanding about the differences among the various enforcement actions available to federal awarding agencies. Other times, a grantee may not respond appropriately to the enforcement action. This may be due to the grantee's failure to understand the nature of the enforcement action, the grantee's appeal rights or the appeals process. Regardless of the cause, a grantee's mistakes concerning enforcement actions can be costly, and a grantee may be forced to repay previously expended funds, lose the grant, or even face debarment from participating in federal grant programs.

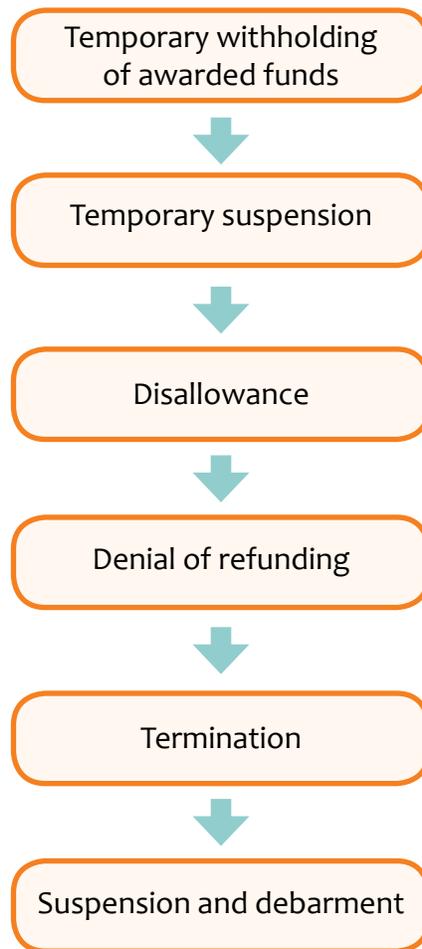
Scope of Discussion

This discussion of federal awarding agency enforcement actions and grantee rights is general in nature. While specific examples are provided to illustrate certain concepts, for the sake of simplicity and consistency, these examples are primarily drawn from programs administered by HHS. The concepts discussed normally apply to other programs and agencies, as many HHS regulations simply implement uniform federal policies, particularly the Uniform Guidance and other OMB issuances.

However, some programs and agencies may have different requirements because of specific statutory provisions or because of different interpretations or implementations of cross-cutting provisions. For example, within HHS, the Head Start program has detailed grants policies and special administrative appeals procedures. Moreover, the CSBG Act includes very specific requirements as to the process for reducing or terminating a CAA's funding. *Because program and agency policies and practices may differ, a grantee should always consult specific program and agency statutes, regulations, policies, and grants manuals (if available).*

Enforcement Actions

A federal awarding agency may take an enforcement action against a grantee for failing to comply with statutory or regulatory requirements, agency policy or other grant terms and conditions. The enforcement action taken may serve as a sanction in itself, or may simply seek to preserve the status quo until the agency can decide on an appropriate sanction. Federal awarding agencies have a variety of enforcement mechanisms available to them. These mechanisms differ in both severity and purpose. As shown in the graphic below, common federal awarding agency enforcement actions, arranged from the least to most severe, include:⁴²



In Detail

Temporary withholding of awarded funds occurs when a federal awarding agency decides to temporarily withhold disbursement of previously awarded funds until a grantee has corrected an item of non-compliance. A federal awarding agency may also temporarily withhold funds by suspending the grantee's authority to obligate any of its awarded funds until the grantee takes corrective action.

Temporary suspension is the temporary withdrawal of the grantee's authority to obligate funds until it has taken corrective action or while the federal awarding agency decides whether the grant should be terminated. A federal awarding agency may use a temporary suspension to preserve the status quo to conduct a more thorough investigation and determine the appropriate type of enforcement action. A temporary suspension should be distinguished from the suspension and debarment process, which is discussed later.

Disallowance is a determination by the federal awarding agency that certain prior expenditures of federal grant funds were not allowable under the applicable federal cost principles or under the specific terms and conditions of the federal award. If costs are disallowed, grantees must repay these costs from non-federal, unrestricted funds. A disallowance may be assessed against a current grantee as well as against a former grantee during the grant closeout process. Additionally, an awarding agency that has fiscal concerns regarding a grantee may request a limited compliance audit by an independent auditing firm or by the agency's Inspector General and base its decision on the audit findings and recommendations. In such circumstances, the grantee is normally allowed to respond to those findings before a disallowance decision is made.

Denial of refunding occurs when the federal awarding agency decides **not** to continue financial assistance beyond the current funding period because the grantee has failed to conduct the grant in compliance with the program's terms and conditions. Although distinct from a termination, a denial of refunding essentially achieves the same result, and is often used in place of termination when the funding period will expire soon.

Termination is the partial or complete cancellation of a grant award at any time prior to the expiration date of the grant award. The federal agency or pass-through entity must provide the grantee with a notice of termination. If the award is terminated for the grantee's failure to comply with federal statutes, regulations, or the terms and conditions of the federal award, the notification must state that the termination decision may be considered in evaluating future applications received from the grantee.⁴³

Suspension and debarment is a process to exclude persons and entities from receiving federal financial assistance, such as grant funds, and from being awarded contracts to be paid from grant funds. Grantees, subrecipients, and contractors under federal grants are subject to the non-procurement debarment and suspension regulations implementing Executive Orders 12549 and 12689 in 2 C.F.R. Part 180.⁴⁴ Suspension and debarment is the most severe of the enforcement actions described here and has wide-reaching consequences, i.e., a government-wide effect.

Suspension as a precursor to debarment should be distinguished from a "temporary suspension," which is an independent enforcement action. When taken in conjunction with debarment, a suspension is a procedural remedy that a federal agency will use to maintain the status quo while it makes a final determination regarding debarment.

A federal awarding agency's decision to take an enforcement action and the type of action taken are the result of many factors. Foremost among those factors are the requirements and restrictions of the relevant statutes, regulations, and policies that govern the operations of the grant program and the awarding agency. Another critical factor is the level of the alleged non-compliance. The decision to take an enforcement action and the severity of the action taken may also be influenced by whether the grantee has a history of prior non-compliance or has received previous warnings from the funding source. Note that this discussion applies only to enforcement actions that may be taken by federal awarding agencies and not to state enforcement actions.

Administrative Appeals

An administrative appeal is the review of a final federal awarding agency's action by an appeals board, hearing officer, or other designated official of the government agency subject to the disputed action. Both the right to make an administrative appeal and the procedures that the awarding agency must follow in the appeals process are determined by the relevant program and awarding agency's statutes, regulations, and policies.

Generally, for a federal awarding agency decision to be appealable, it must provide a right to review and be final and in writing.⁴⁵ Thus, not every enforcement action carries with it the right to an administrative appeal. A temporary withholding of awarded funds is generally not appealable.⁴⁶ However, some programs may permit grantees to take administrative appeals of enforcement actions that ordinarily are not appealable. For example, the Head Start Act and regulations provide that a suspension for more than 30 days is appealable.⁴⁷ Therefore, a grantee should always look at the specific statutes, regulations, and policies governing the program and the funding source to determine whether an administrative appeal is available. Some program regulations or governing statutes may also provide for an optional or mandatory intermediate review or reconsideration by the responsible federal awarding agency official prior to an administrative appeal.

The specific agency board or other entity that will hear an administrative appeal depends upon several factors, including the program's governing statutes and regulations, the federal awarding agency's general governing statutes and regulations, and any self-imposed jurisdictional limitations adopted by the applicable appeals board. A number of federal awarding agencies have general administrative appeals boards or other entities that review agency decisions. Examples of such administrative appeals boards and other entities include the HHS Departmental Appeals Board, the U.S. Department of Labor's Office of Administrative Law Judges, the U.S. Department of Housing and Urban Development's Office of Administrative Law Judges, the U.S. Department of Agriculture's Office of Administrative Law Judges, the Department of Energy's Office of Hearings and Appeals, and the U.S. Civilian Board of Contract Appeals. Other federal grant programs, such as the CSBG program, provide that administrative appeals will begin at the state level. Consequently, administrative appeals involving CSBG funding will be heard and decided by the administering state's officials using that state's own procedures.

The general procedures that apply to an administrative appeal will depend upon the federal awarding agency having jurisdiction over the dispute. Some federal funding programs, however, have specific procedures that may differ significantly from the general procedures applicable to the entity with jurisdiction over the appeal. For example, although Head Start suspension, termination, and denial of refunding appeals are heard by the HHS Departmental Appeals Board, those appeals are governed largely by a set of special procedural rules unique to Head Start appeals, rather than the general procedural rules of the HHS Departmental Appeals Board.⁴⁸

Judicial Review

A grantee disputing its federal awarding agency's decisions may also seek judicial review of those decisions. However, before bringing an appeal in court, a grantee must meet certain jurisdictional requirements regarding the basis and timing of the appeal. If these requirements are not met, the grantee's appeal



will be dismissed, resulting in a waste of time and effort. Moreover, the grantee may have allowed other, administrative remedies to lapse while it pursued the appeal.

The statutes and regulations governing the program or the awarding agency may contain specific provisions either providing for a judicial appeal or limiting resolution of disputes to the discretion of the agency or otherwise restricting judicial review.⁴⁹ Therefore, a grantee should review the program and awarding agency's governing statutes and regulations before pursuing judicial review.

In the absence of specific statutory or other authorization for judicial review, a grantee must rely upon general federal question jurisdiction, i.e., the ability to show that the case arose under federal law and that certain United States constitutional and statutory provisions have been met.⁵⁰ Note that the judicial review provisions of the federal Administrative Procedure Act (APA)⁵¹ alone do not establish jurisdiction for judicial review of federal agency actions. Rather the APA merely expresses a congressional policy that judicial review should generally be available, but does not itself provide a basis for such review.⁵²

In general, judicial review is available only for final federal agency action.⁵³ Finality in this context has two elements: first, the action must mark the "consummation" of the agency's decision making process—it cannot be of a tentative or intermediate nature. Second, the action must be one by which "rights or obligations have been determined" or from which "legal consequences will flow."⁵⁴

Before a grantee can seek judicial review of agency action, it must have exhausted all available administrative remedies.

Before a grantee can seek judicial review of agency action, it must have exhausted all available administrative remedies.⁵⁵ However, exhaustion may be waived in certain circumstances, such as when pursuing administrative remedies would be futile.⁵⁶ These general principles are equally applicable to the grant context.

The two most common standards of review in the judicial appeals process are the "arbitrary and capricious" standard and the "substantial evidence" standard. Under the APA, reviews of rule-making and informal adjudications, which include the issuance of federal regulations through the notice-and-comment process and represent the great majority of federal agency actions, are generally subject to an "arbitrary and capricious" standard.⁵⁷ Under this standard, which is quite deferential to the federal agency, a court will allow an agency decision to stand so long as the agency can demonstrate that it is not arbitrary and capricious by giving a reasonable explanation for its decision based on the information it had at the time.

Formal adjudications, on the other hand, where the federal awarding agency conducts a trial-like hearing with witness testimony, a written record and a final decision, are subject to a more stringent "substantial evidence" standard.⁵⁸ For these more formal actions, a court reviewing the adjudication will require the awarding agency's decisions to be supported by substantial evidence, based on the entire record of the adjudication. "Substantial evidence" review thus allows courts to independently consider whether an agency's factual and policy determinations were warranted in light of all the information before the agency at the time of decision.

Unless the form of relief is specified in a statute governing judicial review, any applicable form of legal action is available, including actions for declaratory judgment (where a judge declares the rights of the parties involved after analyzing the controversy) or mandatory injunction (where a judge orders a party to affirmatively act).⁵⁹ The most common forms of relief sought are usually setting aside the agency action and seeking injunctive relief, i.e., an order by the court requiring the agency to take certain actions.

Notes

¹ 5 U.S.C. § 500 et seq.

² 31 U.S.C. §§ 6301-6308

³ See 43 Fed. Reg. 36860 (August 18, 1978)

⁴ 2 C.F.R. § 200.101

⁵ See 42 U.S.C. § 9916(a)(1)(B).

⁶ 31 U.S.C. § 1341 et. seq.

⁷ 2 C.F.R. § 200.330

⁸ See 2 C.F.R. § 200.93

⁹ See 2 C.F.R. §§ 200.22; 200.23

¹⁰ 2 C.F.R. § 200.331(d)

¹¹ 2 C.F.R. § 200.331(b)

¹² 2 C.F.R. § 200.331; 31 U.S.C. § 7501 et seq

¹³ 2 C.F.R. § 200.331(e)

¹⁴ Byrd Amendment, 31 U.S.C. § 1352; Uniform Guidance, 2 CFR § 200.450(c)

¹⁵ 2 CFR § 200.450(c)

¹⁶ Consolidated Appropriations Act, 2016, P.L. 114-113, Division H – Departments of Labor, Health and Human Services, and Education, and Related Agencies Appropriations Act, 2016, Title V, Section 503(b) (emphasis added).

¹⁷ 31 U.S.C. § 1352

¹⁸ See, e.g., 45 C.F.R. § 93.110 for the regulations applicable to HHS grants

¹⁹ 2 CFR § 200.450(c)(2)

²⁰ See, e.g., Consolidated Appropriations Act, 2016, P.L. 114-113, Division H – Departments of Labor, Health and Human Services, and Education, and Related Agencies Appropriations Act, 2016, Title V, Section 503(b) (prohibiting the use of federal funds to “pay the salary or expenses of any grant or contract recipient, or agent acting for such recipient, related to any activity designed to influence the enactment of legislation, appropriations, regulation, administrative action, or Executive order proposed or pending before the Congress or any State government, State legislature or local legislature or legislative body, other than for normal and recognized executive-legislative relationships or participation by an agency or officer of a State, local or tribal government in policymaking and administrative processes within the executive branch of that government”).

²¹ I.R.C. §§ 501(c)(3), 501(h), 4911(a)

²² 42 U.S.C. §§ 9901 et. seq.

²³ 42 U.S.C. § 9918(b)(2)

²⁴ 42 U.S.C. §§ 9801 et. seq.

²⁵ 42 U.S.C. § 9851(b)

²⁶ 2 CFR § 200.450(c)

²⁷ 5 U.S.C. § 1501(4)

²⁸ 5 U.S.C. § 1502(a)(1)-(2); 5 C.F.R. § 151.121

²⁹ 5 U.S.C. § 1502(a)(1)-(2); 5 C.F.R. § 151.121(a)-(b)

³⁰ 5 U.S.C. § 1502(a)(3)

³¹ 5 U.S.C. § 1503; 5 C.F.R. 151.101(h)

³² 5 U.S.C. § 1501(4)

³³ 5 U.S.C. § 1502(a)(1), (2); 5 C.F.R. §151.121(a), (b)

³⁴ 5 U.S.C. § 1502(a)(1), (3); 5 C.F.R. §151.121(c)

³⁵ 5 U.S.C. § 1503; 5 C.F.R. 151.101(h)

³⁶ 5 U.S.C. § 1503

³⁷ 5 U.S.C. § 1502(c)(4); 5 C.F.R. § 151.122

³⁸ 5 C.F.R. § 151.111(a); U.S. Office of Special Counsel Advisory Opinion 2002-06-04

³⁹ 5 C.F.R. §§ 734.205, 734.208

⁴⁰ 5 U.S.C. § 1504

⁴¹ 5 U.S.C. §§ 1504-1505

⁴² 2 C.F.R. § 200.338

⁴³ 2 C.F.R. § 200.340(b)

⁴⁴ 2 C.F.R. § 200.212

⁴⁵ See Federal Administrative Procedures Act

⁴⁶ See, e.g., [HHS Grants Policy Directive 3.07.D](#)

⁴⁷ See 42 U.S.C. § 9841(a)(3)

⁴⁸ See Head Start Performance Standards

⁴⁹ See, e.g., *Shalala v. Illinois Council on Long Term Care, Inc.*, 529 U.S. 1 (2000) (discussing judicial review of regulations under Medicare).

⁵⁰ 28 U.S.C. § 1331; See, e.g., *Bell v. New Jersey*, 461 U.S. 773, 777 n.3, 792 (1983); *Andrus v. Charlestone Stone Prods. Co., Inc.*, 436 U.S. 604, 607 n.6 (1978); *Califano v. Sanders*, 430 U.S. 99, 104-07 (1977)

⁵¹ 5 U.S.C. §§ 701-706

⁵² See *Califano v. Sanders*, 430 U.S. 99, 104-07 (1977)

⁵³ See, e.g., *Bell v. New Jersey*, 461 U.S. 773, 777-78 (1983)

⁵⁴ *Bennett v. Spear*, 520 U.S. 154, 177-78 (1997)

⁵⁵ See, e.g., *Myers v. Bethlehem Shipbuilding Corp.*, 303 U.S. 41, 50-51 (1938)

⁵⁶ See, e.g., *Bowen v. City of New York*, 476 U.S. 467, 485 (1986)

⁵⁷ 5 U.S.C. § 706(2)(A)

⁵⁸ 5 U.S.C. § 706(2)(E)

⁵⁹ See 5 U.S.C. § 703

Chapter Two: Community Services Block Grant

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Chapter Two

Community Services Block Grant

A. History

“Because it is right, because it is wise, and because, for the first time in our history, it is possible to conquer poverty, I submit, for the consideration of the Congress and the country, the Economic Opportunity Act of 1964. The Act does not merely expand old programs or improve what is already being done. It charts a new course. It strikes at the causes, not just the consequences of poverty...”¹

With these words, President Lyndon B. Johnson submitted to Congress the centerpiece of his War on Poverty, the Economic Opportunity Act of 1964 (EOA). In his message to Congress, President Johnson described one of the central components of the Act:

[T]hrough a new Community Action program we intend to strike at poverty at its source – in the streets of our cities and on the farms of our countryside among the very young and the impoverished old. This program asks men and women throughout the country to prepare long-range plans for the attack on poverty in their own local communities.... The most enduring strength of our nation is the huge reservoir of talent, initiative and leadership which exists at every level of our society. Through the Community Action Program we call upon this, our greatest strength, to overcome our greatest weakness.²

The EOA was enacted on August 20, 1964. It authorized funding for community groups to be provided directly from the federal government, without involvement of state and local political forces. Over 1,000 of these community groups, which came to be known as Community Action Agencies (CAAs), were established and funded through the EOA. Many of these CAAs are still in existence today.

The EOA established a number of other programs aimed at improving the lives of low-income Americans, such as Job Corps and Volunteers in Service to America (VISTA). It also created the Office of Economic Opportunity (OEO) to lead the War on Poverty. President Johnson appointed Sargent Shriver as the first director of the OEO. Shriver, who had served under his brother-in-law, President John F. Kennedy, as the Peace Corps’s first director and then as a special assistant to President Johnson, was tasked with designing the President’s War on Poverty. In addition to overseeing the Economic Opportunity Act programs, OEO incubated other key anti-poverty initiatives—including Head Start, the Legal Services Program, and the Comprehensive Health Services Program—that Congress later separately authorized and funded.



Written into the EOA was the mandate that Community Action Programs at the local level be developed, conducted and administered with the “maximum feasible participation of residents of the areas served and members of the groups served.” In 1966, Congress passed the Quie Amendment, which required at least one-third of the members of CAA boards to be representatives of the poor.

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However, big city mayors claimed that maximum feasible participation of the poor “undermin[ed] the integrity of local government” and they sought local government involvement in the CAA’s planning groups.³ In 1967, Congress responded by passing the Green Amendment, which created a three-part structure for CAA boards. One-third of the board was to be composed of public officials or their representatives; at least one-third of the board was to be composed of democratically selected representatives of the poor in the area served; and the remainder was to be composed of officials of business, industry, labor, religious, welfare, education or other major groups and interests in the community. During this time period, Congress also amended the EOA to include restrictions on political activities of CAAs and their employees. These amendments were passed in response to advocacy and voter registration efforts by CAAs, conducted in some cases as part of the civil rights movement.

By 1969, OEO and CAAs had initiated many successful self-help programs. President Richard Nixon’s administration oversaw the transfer of several large programs from the OEO to the Department of Health, Education, and Welfare, and the Department of Labor. Along with the programs went administrative oversight responsibility for a substantial part of CAA funding.

At the start of his second term in 1973, President Nixon did not request any funds from Congress for OEO’s Community Action Program. Congress nevertheless provided the funds. Nixon appointed Howard Phillips as Director of OEO, told him to dismantle and close the agency, and to not spend the money Congress provided. After a series of lawsuits, the Federal District Court in Washington, D.C. ruled that the President could not refuse to spend funds that had been appropriated by Congress. Phillips resigned without being confirmed by the Senate. Throughout the 1970s, Congress continued to fund CAAs, which helped communities and neighborhoods initiate self-help projects such as gardening, solar greenhouses, and housing rehabilitation. Congress also initiated home weatherization and energy crisis programs in this era.

In 1981, President Ronald Reagan took office, having won the presidency in a landslide election on a platform of limiting federal government spending. Later that year, Congress repealed the EOA and passed legislation championed by the Reagan administration that combined 57 formerly discretionary grants into nine block grants and reduced funding for those programs. The idea behind changing these grants from discretionary grants to block grants was to reduce federal spending, limit the federal government’s role in social programs, and transfer responsibility and authority for those programs to state and local governments. The Community Action Program was one of the discretionary grant programs repealed in 1981 and replaced with a block grant program – the Community Service Block Grant (CSBG) program.

The Community Action movement today continues to change lives, improve communities, and make America a better place to live. Approximately 1,000 CAAs are fighting poverty and providing services to over 15 million people across the country.⁴ The majority of these CAAs are nonprofit organizations, and the remainder are local government entities.

While CSBG may not necessarily be a CAA’s largest source of funding, it is particularly important for two reasons: (i) CSBG funds may be used not just to provide anti-poverty services but also to support and enhance



a CAA’s various anti-poverty programs and link them with each other and other related programs in the community; and (ii) the CSBG Act specifies that each CAA must have a tripartite board.

Today, at the federal level, the CSBG program is administered by the Office of Community Services (OCS), which is situated within the Administration for Children and Families (ACF) of the U.S. Department of Health and Human Services (HHS). Each state has an office designated by the governor to oversee the CSBG program in that state.

B. Overview of Laws and Guidance

Federal Block Grants

Unlike with a discretionary grant, where the federal government is primarily responsible for grant administration, with a block grant, states are primarily responsible for grant administration and have more flexibility in their interpretation of the federal statute authorizing the program. Examples of block grants include CSBG, Low-Income Home Energy Assistance Program (LIHEAP), Temporary Assistance for Needy Families (TANF), the Social Services Block Grant (SSBG), and the Community Development Block Grant (CDBG). An example of a discretionary grant program is the Head Start program.

The federal government must award a block grant if the grantee—usually a state—meets the requirements of the authorizing statute and any implementing regulations. The amount of block grant funds awarded to a state is determined by a formula in the authorizing statute; the federal funding agency must award the amount Congress has allotted and no less. However, the federal funding agency can refuse to award grant funds if a grantee fails to meet the applicable statutory and regulatory requirements. Once a state chooses to participate in a mandatory grant program, it must also follow the program’s authorizing statute and regulations. To participate in a block grant program, a state usually must submit a state plan detailing how it will use the grant funds and assuring the federal agency administering the program that the state will comply with applicable statutory and regulatory requirements. Once the awarding agency approves a state plan, the state must follow that plan. However, states generally have significant leeway in interpreting the program requirements and their own state plans.

After receiving block grant funds, states often sub-grant or subcontract with other entities, such as CAAs, to operate programs or provide services with the funds. Because states typically pass block grant funding through to sub-grantees, block grants are sometimes referred to as “pass-through” grants.

Federal Block Grant Regulations

The main law governing the CSBG program today is the federal CSBG Act, which was originally passed in 1981 and has been revised a number of times since then, most recently in 1998.⁵ The CSBG program is also subject

to HHS’s block grant regulations, 42 C.F.R. Part 96. These regulations specify that the states are primarily responsible for interpreting the governing law of a block grant program and recognize that various states may reach different interpretations of the same statutory provisions. The CSBG Act, however, does give HHS the authority to issue rules and regulations to provide for enforcement of the Act’s political activity restrictions.

Information Memoranda and Terms and Conditions

At the federal level, OCS issues further guidance specific to the CSBG program in the form of Information Memoranda (IMs). Although IMs are non-binding guidance, they serve as a good indication of OCS’s interpretation of the federal CSBG Act and regulations.

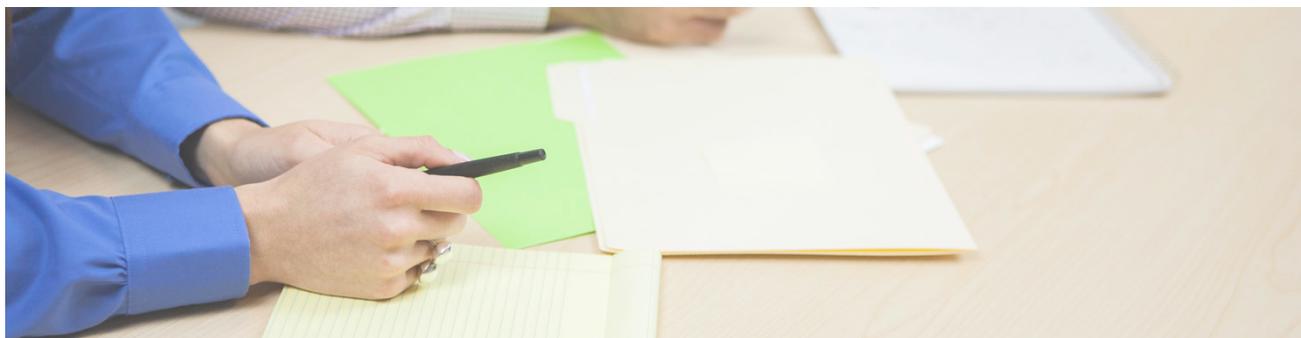
Terms and conditions set forth the rules that a grantee agrees to comply with when it enters into a grant agreement with the awarding agency. When states accept CSBG funds, they become bound by terms and conditions of the CSBG grant from the federal government. Copies of the [IMs](#) and terms and conditions are available on OCS’s [website](#).

Uniform Guidance

The federal CSBG Act requires states to ensure that the “cost and accounting standards of the federal Office of Management and Budget” apply to recipients of CSBG funds.⁶ This language originally referred to circulars (e.g., OMB Circulars A-122, A-87, A-110, etc.) issued by the Office of Management and Budget (OMB) as general guidance to federal grantees (e.g., states, nonprofits, universities, etc.) regarding their use of federal funds. These circulars have been consolidated and replaced by federal regulations (2 Code of Federal Regulations (C.F.R.) Part 200) which are commonly referred to as the Uniform Guidance, Super Circular, or Omni Circular.

With respect to its CSBG funds, the Uniform Guidance specifies that a CAA must comply with the following provisions:

- The acronyms and definitions in Subpart A;
- The general provisions in Subpart B;
- Public notice of federal financial assistance programs requirement in Section 200.202 in Subpart C;
- The rules on distinguishing between subrecipients and contractors, pass-through entity/requirements, and fixed amount subawards in Sections 200.330 – 200.332 of Subpart D;⁷
- Cost principles in Subpart E (which OMB has interpreted as the OMB “cost and accounting standards” referred to in the CSBG Act); and
- Single audit requirements in Subpart F.



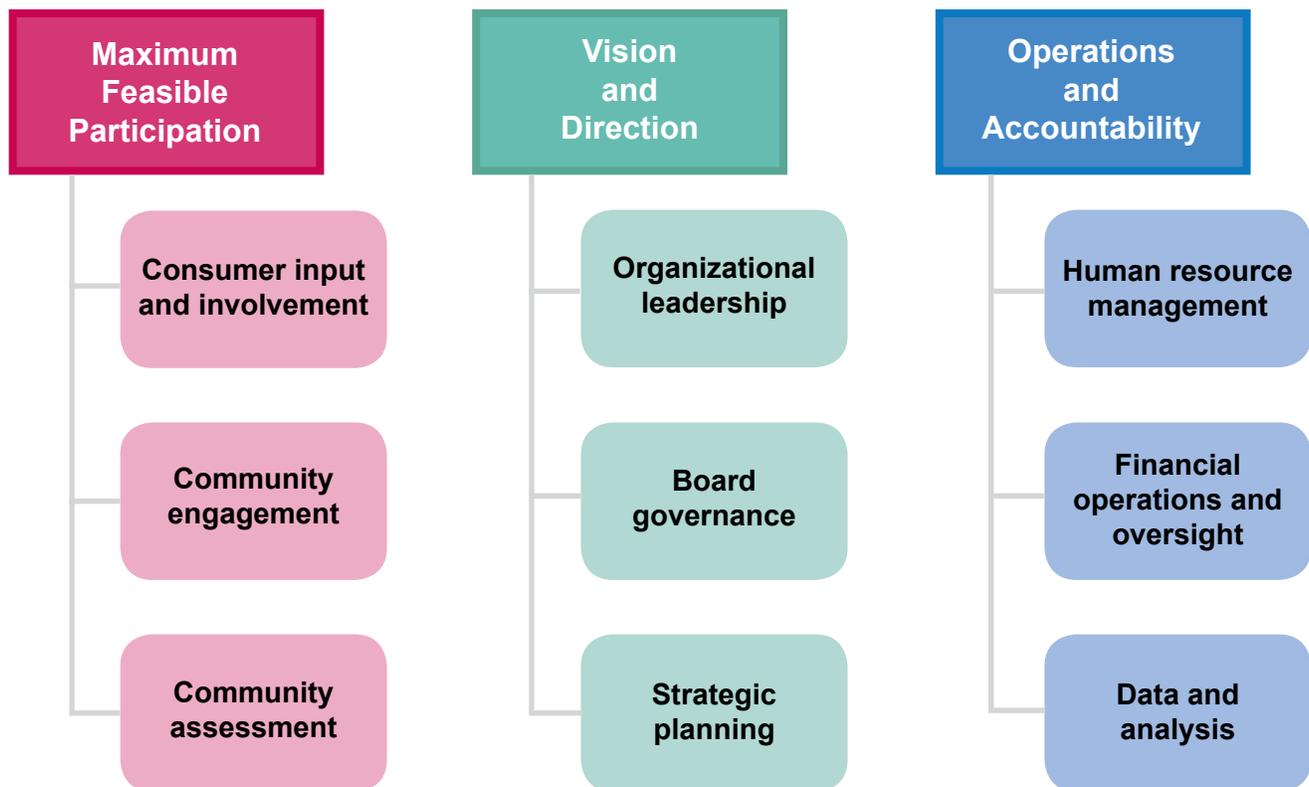
A state may require CAAs to comply with the remainder of the uniform administrative requirements in Subparts C and D of the Uniform Guidance with respect to CSBG funds by incorporating those standards by reference in the CSBG agreement with CAAs and/or in the state CSBG statute or regulations, if any exist.

State CSBG Laws and Regulations

A number of states have issued CSBG or Community Action laws and/or regulations that help facilitate and flesh out the federal CSBG Act. Many state CSBG offices also issue CSBG policies and procedures or similar guidance.

CSBG Organizational Standards

The CSBG Organizational Standards Center of Excellence (COE) developed a set of comprehensive organizational standards to ensure that all CSBG eligible entities have the capacity to provide high-quality services to low-income individuals and communities. OCS published the standards, which are organized into three thematic groups, in OCS [IM 138](#).



OCS expects states to adopt the proposed organizational standards. If a state chooses to adopt, or continue using, its own organization standards, those standards must be at least as rigorous and comprehensive as the COE-developed standards. Whether states use the COE standards or develop and implement their own, states are expected to use the standards to assess CAAs starting in FY 2016. This means that the standards must be in a state's FY 2016 plan, which was due on September 1, 2015.



Grant Agreement

All state CSBG offices enter into contracts or grant agreements with CAAs that spell out the responsibilities of the state and the CAA under the program. These agreements provide specific terms and conditions governing the performance of the grant by the CAA. They generally address topics such as: the amount of funds awarded; the scope of work; performance goals; monitoring and reporting; payment methods; access to records; and enforcement actions. When questions arise about a CAA's responsibilities under the CSBG program, it is often best to start by looking at the CSBG funding agreement with the state.

C. Allocation and Use of Funds

A Unique Block Grant

Although CSBG is a block grant, states have less leeway in administering it than they do with most other block grant programs. For example, states do not have much discretion to choose which local organizations receive CSBG funds; they must pass through 90% of the funds they receive to what the statute calls "eligible entities."⁸ (Throughout this Guide, we use the terms eligible entities and CAAs interchangeably.) In addition, a state cannot reduce or terminate a CAA's funding below the proportion the CAA received in the previous year without following procedures specified in the federal CSBG Act, including providing notice and an opportunity for a hearing.⁹ A CAA's programs and services are determined on the basis of a local community needs assessment, rather than by the state.¹⁰ CSBG funding may be used not only to provide direct services, but also, in the words of OCS [IM 37](#), "to undertake a very broad range of activities, including linking and strengthening other anti-poverty programs and services."

State Discretionary Funds

States may use the remaining 10% of their allotted CSBG funds for a variety of purposes, including expenses associated with administering the program. However, the maximum yearly amount a state may spend on administrative expenses, including monitoring, is 5% of its total CSBG allotment for that year. The CSBG Act specifies, however, that the cost of providing training and technical assistance will not be considered administrative expenses.¹¹

HHS also receives discretionary funds that it can use for a variety of CSBG-related purposes. Examples of these purposes include awarding funds to CSBG-network organizations to provide training and technical assistance to CAAs and awarding funds on a competitive basis to organizations conducting community economic development activities, rural community development activities, and neighborhood innovation

projects. Recipients of community economic development, rural community development, and neighborhood innovation funds may, but are not required to, be CAAs.¹²

Purposes and Goals of CSBG Act

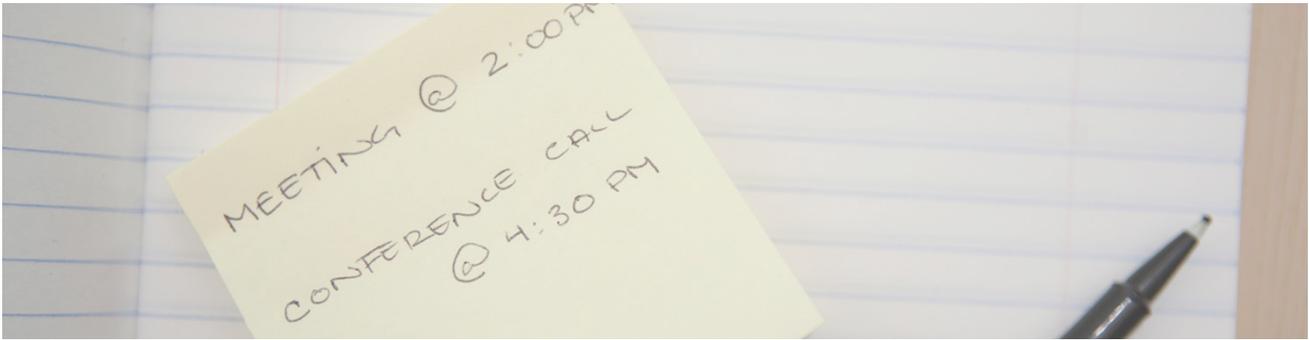
The purposes of the CSBG Act are “to provide assistance to States and local communities working through a network of Community Action Agencies and other neighborhood-based organizations, for the reduction of poverty, the revitalization of low-income communities, and the empowerment of low-income families and individuals in rural and urban areas to become fully self-sufficient.” These three broad purposes are to be accomplished by the following means that emphasize the flexible and community-based nature of the CSBG program:¹³



D. Income Eligibility

To be eligible for CSBG services or benefits, clients must be at or below 100% of the federal poverty line as determined by OMB based on the most recent federal census data and as revised annually (or more frequently) by HHS. A state may permit eligible entities to provide CSBG services to clients at or below 125% of the federal poverty line whenever the state determines that doing so serves the objectives of the CSBG program.¹⁴ If the state has not specified how to calculate a client’s income for the purpose of determining client eligibility for CSBG services or benefits, a CAA may adopt its own written procedures for doing so. These procedures may, based on the CAA’s community needs assessment, give priority to certain client populations within the applicable income limit.

Where a CAA program serves clients who meet the CSBG income eligibility requirements as well as clients who do not (or from whom the CAA collects no income eligibility documentation), the CAA must be sure to use non-CSBG funds to cover the costs of providing services to clients who do not meet the CSBG income eligibility requirements. For more information on this topic, see CAPLAW’s [CSBG Q&A on Client Eligibility](#).



The CSBG Act does not restrict eligibility for CSBG programs and services based on immigration status and OCS [IM 30](#) states that, “Non citizens, regardless of their alien status, should not be banned from CSBG programs based solely on their alien status unless the exclusion is already authorized by another statute.”

E. Tripartite Boards

Governing Law

The tripartite board requirement remains a hallmark of Community Action. Like its predecessor, the EOA, the CSBG Act generally requires that each CAA have a tripartite board made up of three sectors – at least one-third of the board must be representatives of the low-income people being served, one-third must be public officials or their representatives, and the remainder must represent other major groups and interests in the community.¹⁵ The purpose of this requirement is to obtain input from each of the sectors on community needs, resources, and program effectiveness.

OCS [IM 82](#) provides further federal guidance on tripartite boards. Although neither states nor CAAs are bound by this guidance, they may find it helpful in understanding the composition, role, and responsibilities of the tripartite board. Tripartite boards are often also addressed in state CSBG or Community Action statutes or regulations, which must be consistent with the federal CSBG Act.

Other sources of law governing CAA tripartite boards vary depending on whether a CAA is a nonprofit corporation or a government entity. A nonprofit CAA’s board is governed by the nonprofit corporation law in its state, while a public CAA’s tripartite board is governed by whatever authority the local governing body (such as a city council or board of county commissioners) may have delegated to it through a local ordinance or other official act.

Examples:

Other Board Requirements

Boards of CAAs with Head Start programs are subject to the Head Start Act’s requirements on composition, responsibilities, and conflicts of interest.¹⁶

A board of a CAA that operates a federally qualified community health center or intends to qualify as a Community Housing Development Organization (CHDO) must meet additional composition requirements.¹⁷

A CAA's bylaws also govern a CAA's tripartite board. Generally, tripartite boards adopt bylaws to address their composition and specify how they will operate. Bylaws typically cover issues such as board size, composition and selection, board members' terms, board meeting procedures, officers, and committees. Because of the tripartite board structure required by the federal CSBG Act, CAAs must include a number of provisions in their bylaws not found in a typical nonprofit's bylaws. To assist CAAs in understanding and revising their bylaws, CAPLAW has developed a *Bylaws Toolkit* for CAAs. Information about the *Bylaws Toolkit*, including how to order it, can be found on CAPLAW's [website](#).

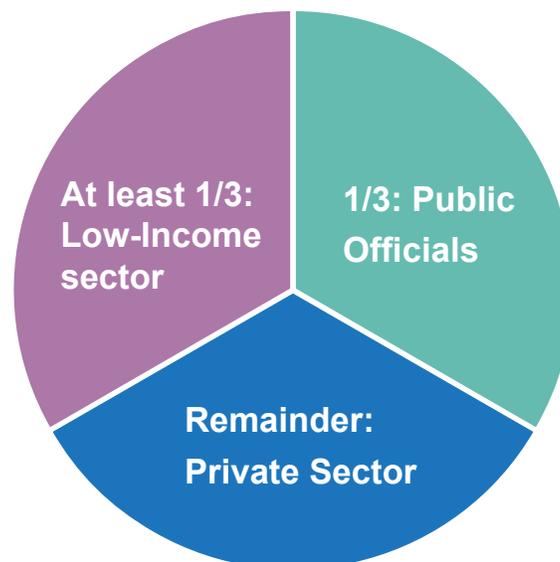
Powers

The powers of a CAA tripartite board depend on whether the CAA is a nonprofit corporation or a government entity. The powers of a nonprofit CAA's tripartite board are established by state nonprofit corporate law, which usually grants the board broad powers, through a statement such as, "All corporate powers shall be exercised by or under the authority of, and the affairs of the corporation managed under the direction of, its board of directors." As mentioned previously, the powers of a public CAA's tripartite board depend on the authority delegated to it by the local governing body.

Although many people think of a public CAA's tripartite board as an advisory board, the federal CSBG Act actually specifies a more active role. According to the CSBG Act, a public CAA "shall administer the community services block grant program through ... a tripartite board." Thus, the board is to be an administering board, not simply an advisory board. Moreover, it is clear from the CSBG Act that a public CAA's low-income board members (and, presumably, other board members as well) must make decisions about and participate actively in the development, planning, implementation, and evaluation of the CAA's CSBG program.¹⁸

Composition and Selection

The federal CSBG Act requires that the board be composed of three sectors; however, it does not require that the three sectors be equal in size. The CSBG Act specifies the following:¹⁹



Thus, according to the federal CSBG Act, a CAA tripartite board may comprise three sections of equal size or it may be composed of more than one-third low-income sector board members, fewer than one-third private

sector board members, and exactly one-third public sector board members. In some cases, however, state CSBG laws or regulations require that the three sectors be of equal size.

It is important to note that the federal CSBG Act requires that the eligible entity select the members of the tripartite board.²⁰ For a nonprofit CAA, this means that the CAA tripartite board selects board members. For a public CAA, this means the local governing body (e.g., city council or board of county commissioners) selects board members, unless that body has delegated the responsibility to the tripartite board itself. However, both nonprofit and public CAAs must use a democratic process to select low-income sector board members. This process is described in greater detail below.

PRACTICE TIPS

Board Composition and Selection Recommendations

Specify in bylaws that the board selects public and private sector board members, unless state CSBG law or regulations require the board to select its members in another manner that is consistent with federal CSBG Act.

Ask board candidates to complete an application to help ensure they meet the required qualifications for service on the board, including those of their particular board sector, and determine if their particular skills and backgrounds meet the board’s current needs.

For nonprofit CAAs, require a board vote to seat all board members and only permit a vote against a low-income sector candidate selected through a democratic process if the candidate does not meet the qualifications specified in applicable law or the CAA’s bylaws (e.g., for a Head Start grantee, individuals with financial conflicts of interest or who have relatives working for the CAA). Generally, having the board vote to seat all board members prevents the CAA from running afoul of certain state nonprofit corporation laws that only permit external third parties that appoint board members to remove those board members.

Establish a standing governance committee responsible for the ongoing needs of the board rather than using a nominating committee that meets only when there are board positions to fill.

Example:

Governance Committee Responsibilities

- (i) Oversee the low-income sector board member democratic selection process;
- (ii) recommend candidates for public and private sector board seats;
- (iii) work to fill board vacancies when they arise;
- (iv) develop written job descriptions/ expectations for board members;
- (v) assign existing board members to mentor new board members;
- (vi) coordinate orientation for new board members and training for all board members;
- (vii) coordinate the board’s periodic evaluation of itself and of individual board members; and
- (viii) coordinate periodic review of the CAA’s articles of incorporation and bylaws.

Low-Income Sector

At least one-third of the tripartite board members must be selected in accordance with democratic procedures adequate to ensure that they are representative of low-income individuals and families in the

community or area served by the CAA.²¹ The individuals selected to serve as low-income representatives do not necessarily need to be low-income themselves. However, because the CSBG Act specifies that its goals are to be achieved through maximum participation of low-income people, CAAs should ensure that some, if not all, of its low-income sector representatives are low-income themselves or have recently moved out of poverty.

The federal CSBG Act does not impose a residency requirement for low-income sector board members of a nonprofit CAA. Rather, the Act states that if a low-income sector board member is selected to represent a specific neighborhood within in its service area, he or she must live there.²² Thus, a residency requirement only exists if a CAA's bylaws require that a low-income sector board member represent a specific neighborhood in the CAA's service area. For example, assume that a CAA serves three counties and that its bylaws require the CAA to select one low-income sector board member to represent each county. The CAA holds an election in one of the counties to elect a low-income sector board member to represent that county. The person selected must live in that county. However, if the CAA's bylaws do not tie low-income sector board member selection to a particular county or other geographic area, its low-income sector board members need not live in any particular neighborhood.

For public CAAs, low-income sector board members must reside in the neighborhood served. Presumably, the neighborhood served would be the CAA's entire CSBG service area.

Democratic Selection

In general, the CAA's bylaws may, but do not need to, describe the procedure used to select low-income sector board members. However, some states' CSBG laws, regulations, or other guidance require CAA bylaws to include the details of the democratic selection procedure. Where state law does not require inclusion of the democratic selection procedure in the bylaws, a CAA can describe the democratic selection process generally in its bylaws and adopt more detailed procedures by means of a board resolution.

Examples:

Democratic Selection Procedures

Election by ballots cast by the CAA's clients and/or by other low-income people in the CAA's service area. Ballots could be cast, for example, at designated polling place(s) in the service area, at the CAA's offices, or via the internet.

A vote at a community meeting of low-income people. A CAA may get better turnout if the meeting serves not simply to select low-income sector directors but also to address a topic of interest to low-income people in the community.

Designation of community organizations composed predominantly of and representing low-income people in the service area, which in turn select a representative to serve on the CAA board. For example, a Head Start policy council, low-income housing tenant association, or the board of a Federally Qualified Community Health Center may designate a representative to serve on the CAA's board.

Low-income people in the community served by the CAA must have input at some point in the selection process. For this reason, the CAA's executive director or tripartite board should not simply select the low-income sector board members, nor should the executive director or board of another low-income service provider merely choose staff members of that organization to serve on the CAA's board (unless low-income people make up a majority of that service provider's board and that board votes to select a staff person to represent it on the CAA board). For more information about different democratic election procedures used by CAAs, see CAPLAW's [Raising the Low-Income Voice: Case Studies in Democratic Selection Procedures](#).

Public Sector

According to the federal CSBG Act, one-third of the tripartite board must be composed of elected public officials or their representatives. If not enough elected public officials are reasonably available and willing to serve on the CAA board, appointed public officials or their representatives may be selected.²³

The EOA briefly required that public sector board members be chief elected officials or their representatives, but that requirement was repealed in 1972 and was not included in the CSBG Act. Nevertheless, bylaws of many CAAs continue to require that public sector board members include or be chosen by the chief elected local officials. A CAA can choose to include chief elected officials on its board; however, a CAA may not want to require this in its bylaws. Instead, CAAs should consider drafting the bylaws to provide flexibility as to which public officials will serve on the board.

For public CAAs, the chief elected local officials usually have significant input or final say on many of the decisions affecting the CAA. Therefore, it may be redundant to include them on the tripartite board. Instead, a public CAA may want to consider including other public officials on the tripartite board.

PRACTICE TIPS

Public Sector Bylaws Provisions

Consider specifying that the board selects the public officials who will serve or appoint representatives to serve, rather than specifying in the bylaws the public officials entitled to serve or appoint representatives to serve.

Make the appointment of representatives of public officials subject to approval by the CAA's board.

Clarify that if a public official appoints a representative to serve, that person, and not the public official, is the board member and gets to vote at board meetings.

In some cases, conflict of interest rules make it preferable for public officials to designate representatives. For example, state or local ethics or conflict of interest rules or the U.S. Department of Housing and Urban Development (HUD) conflict of interest rules may affect whether public officials can serve on a CAA's board and what they can do as board members.

The federal CSBG Act requires that public officials hold public office on the date of selection to the tripartite board.²⁴ Some state CSBG laws/regulations further require that public officials be "currently holding office" while they are on the tripartite board. CAAs should consider requiring in the bylaws that public sector board members serve only while they (or, in the case of representatives, their appointing officials) hold public office, or no longer than some short period after they leave public office (e.g., one to three months).



Private Sector

The remainder of the board members must be officials or members of business, industry, labor, religious, law enforcement, education, or other major groups and interests in the community served.²⁵ This sector is sometimes called the “private sector,” but in fact, as indicated by the types of interests listed in the CSBG Act’s tripartite board provision, it may include both public and private sector groups and interests.

Unless state CSBG laws or regulations require otherwise, the grantee may choose either individuals or organizations that are asked to designate a representative to fill private sector board seats. CAAs may want to consider leaving the choice of all or some of the private sector board members up to the tripartite board (or local governing body, in the case of some public CAAs), rather than to other organizations, if this is permitted under the applicable state CSBG laws or regulations. Doing this allows the board to play a more active role in determining who the private sector board members will be.

PRACTICE TIPS

Private Sector Selection

Choose people who are involved with community groups and interests that will be good partners for the CAA and its programs.

Choose people who have the skills, experience, and resources that the CAA needs (e.g., people with financial expertise, fundraising skills and contacts, or with the various forms of expertise needed to fulfill the Head Start board composition requirements).

Petitions for Representation

Under the federal CSBG Act, states must require CAAs to establish procedures for a low-income individual, community organization, religious organization, or representative of low-income individuals that considers its organization or low-income individuals to be inadequately represented on the board to petition the CAA for adequate representation.²⁶ If the state does not require specific procedures, each CAA can develop its own. It is best to include these procedures in the CAA’s bylaws.

Board Size

The federal CSBG Act does not include requirements about tripartite board size. However, some state CSBG laws, regulations, or contracts impose tripartite board size requirements. Many states allow the bylaws to

state the board size in terms of a range. Doing this offers the organization more flexibility than specifying an exact number of board members. Typical bylaws language in such a case might say that the size of the board will be “no less than 15 nor more than 24 members as set forth by resolution of the board.”

PRACTICE TIPS

Board Size Bylaws Provision

Specify a range of directors rather than a specific number to provide the board with the flexibility to add directors as additional skills, experience, or qualifications are needed, rather than to fill an arbitrary number of positions.

State a fairly generous range of directors to preclude repeated amendments to the bylaws every time the board is expanded.

The appropriate size of a CAA tripartite board will depend on the CAA’s circumstances, such as the geographic area it serves, its budget and staff size, and the number of programs it runs. On the one hand, the larger the board, the more difficult, expensive, and time consuming it can be to give board members notice of board meetings. Similarly, with a very large board, it can also be more difficult to obtain a quorum of board members at board meetings so that business may be conducted. Having a large board can also increase the board’s reliance on the organization’s management staff and lessen management’s accountability to the board. On the other hand, the smaller the board, the more difficult it may be to obtain community participation and input and to get committee work done. Small boards can also lessen accountability if only a few people are making decisions.

PRACTICE TIPS

Advisory Boards

One alternative to having a large board is to create an advisory body, honorary council, or similar group consisting of prominent individuals or experts on technical issues. This group can have non-voting advisory status and provide information and advice to the board of directors to consider in making its decisions. It can also help the organization in its fundraising campaigns. Because the individuals who are members of these advisory bodies are not voting board members, they do not count towards determining whether a quorum is present and are not expected to attend board meetings. However, they can be called upon as needed by the board for advice and assistance.

Terms

The federal CSBG Act is silent as to terms for board members. CAAs should consult their states’ CSBG laws to determine whether they contain any term length requirements. The CAA’s bylaws should specify the term for which board members serve before they must be re-elected or re-appointed to the board. Each of the three sectors should have a specific term length. Generally, a CAA can choose whether to make the terms for each sector the same length (e.g., three-year terms for each sector) or to vary terms by sector (e.g., three-year terms for the low-income and private sectors and one-year terms for the public sector).

CAAs should consider not permitting public officials (or their representatives) to serve automatically on the tripartite board for as long as they (or their appointing officials) hold public office, unless this is required by state CSBG law. Instead, CAAs could give public sector board members a specific term length.

Many CAAs also use staggered terms for their directors. With staggered terms a certain portion of the board will be up for election in any given year. Using staggered terms ensures that there is never a board composed entirely of new members. Staggered terms are especially beneficial for CAAs because of the important information existing board members can share with new board members about the requirements of the CSBG Act and other unique legal and practical issues that CAAs face.

Term Limits

The federal CSBG Act is silent as to term limits for board members. CAAs should check whether their state CSBG laws require term limits for board members. Nonprofit CAAs should also check their state nonprofit corporate laws for any required term limits.

If term limits are not required by law, a CAA can decide whether to adopt them.

Advantages of Term Limits:	
+	Ensures a variety of perspectives on the board.
+	Helps an organization expand its base of contacts for fundraising and other purposes.
+	Educates a larger sector of the community about the organization and its programs.
+	Prevents a concentration of power among a small group of long-time leaders.
+	Provides a diplomatic way for board members to exit the board.

Disadvantages of Term Limits:	
-	Loss of board members with specific expertise regarding the organization's programs.
-	Loss of institutional memory.
-	Lack of qualified board members who are true supporters of the organization and its programs.

Even with those organizations that do impose term limits, many allow board members who have completed the maximum number of terms to return to the board after a one-year sabbatical if re-elected.

Board Responsibilities

The role and core responsibilities of nonprofit boards and board members are similar for all types of organizations regardless of mission, budget size, funding source, or the organization's unique history and culture. Like all nonprofit boards, a nonprofit CAA's tripartite board is charged with oversight of the CAA mission and overall management of the CAA's assets. At a minimum, a nonprofit CAA board's oversight role vests the board with five core responsibilities:

Five Core Board Responsibilities

✓	Defining mission and programs and monitoring activities to ensure that they are furthering that mission;
✓	Setting organization-wide policy;
✓	Monitoring finances to ensure the CAA has adequate resources and is managing them appropriately and in compliance with legal and funder requirements;
✓	Managing risk and safeguarding assets; and
✓	Selecting, determining compensation, and evaluating performance of the chief executive.

In addition to these core responsibilities, nonprofit CAA boards have other unique responsibilities based on the federal CSBG Act, state nonprofit and CSBG laws and regulations, and the CAA's own articles of incorporation, bylaws, and resolutions. The federal CSBG Act requires all CAA boards (nonprofit and public) to administer the CSBG program and to "fully participate in the development, planning, implementation, and evaluation of the [CSBG] program." The board will also likely incorporate in some way the purposes of the CSBG Act, as well as the historical mission of the CSBG program (i.e. reducing poverty, revitalizing low-income communities, and empowering low-income families and individuals) in defining the mission of the CAA and its own role in ensuring that the CAA's activities focus on furthering that mission. Finally, each board will determine for itself other responsibilities that it will take on, such as fundraising and advocacy.

The role, responsibilities, and authority of public CAA tripartite boards are usually narrower than those of nonprofit CAAs. Although, like all CAAs, public CAAs are required by the federal CSBG Act to administer the CSBG program and to participate in the development, planning, implementation, and evaluation of the CSBG program, their specific duties and powers are determined by the governing body of the public entity, such as the county board of commissioners. For example, many public CAA tripartite boards may not be as involved as nonprofit CAAs are in setting agency-wide policy or in managing risks and safeguarding assets. For a fuller explanation of the role of boards in public CAAs, please refer to CAPLAW's [Purely for Public CAAs Training Module](#).

F. State Plans

Application and Plan

To receive CSBG funds, each state submits an application to OCS. In the application, the governor designates a state agency to administer the CSBG program at the state level. The application must also include a state plan detailing how the state will run the CSBG program during the period covered by the plan, which may be either one or two fiscal years. The state must submit the application and plan to OCS at least 30 days before the first fiscal year covered by the plan. OCS then reviews each state plan and either notifies the state that the



idea → plan → action

state plan is approved or requires the state to make changes to the plan and re-submit the plan to OCS.²⁷ Once OCS has approved the state plan, the state must follow the plan. However, it can revise the plan, as discussed below.

Public Inspection and Hearings

Before the state submits the plan to OCS, it must make the plan available for public inspection in a way that will facilitate the public's review of and comment on the plan. In addition, the state must also hold a public hearing on the plan. The hearing must be held with sufficient time and statewide distribution of notice to provide the public an opportunity to comment on the proposed use and distribution of funds for the period covered by the state plan.²⁸ In addition, the state must hold at least one legislative hearing every 3 years in conjunction with development of the state plan.²⁹

Elements

The state plan must include information required by OCS, as well as certain other information spelled out in the federal CSBG Act.³⁰ In particular, the plan must contain information provided by the state's eligible entities about their use of funds from the 90% pass-through, including descriptions of the following:

- Service delivery system for services targeted to low-income people that are provided or coordinated with CSBG funds;
- How CAAs will develop linkages to fill identified gaps in services by providing information, referrals, case management, and follow-up consultations;
- How CAAs will coordinate the CSBG funds they received from the 90% pass-through with other public and private resources; and
- How CAAs will use CSBG funds to support innovative community and neighborhood-based initiatives related to the anti-poverty purposes of the CSBG Act.

The plan must also describe how the state will use its 10% discretionary funds, including how it will support innovative community and neighborhood-based initiatives related to CSBG Act purposes.

Assurances

In addition, the federal CSBG Act requires the state plan to include a number of assurances by the state that it will take certain actions or require eligible entities to take certain actions in implementing the CSBG program.³¹

Such assurances include:

- Supporting activities designed to assist low-income people, homeless people, and migrant or seasonal farm-workers, and include a description of how those activities will meet seven specified anti-poverty goals;
- Assuring that CSBG funds will be used to address the needs of youth in low-income communities and that emergency services to prevent hunger among low-income people will be provided;
- Coordinating anti-poverty programs in each community in the state;
- Establishing linkages between governmental and other social services programs to assure that those services are delivered effectively and without duplication;
- Coordinating emergency energy crisis intervention administered as part of LIHEAP;
- Coordinating employment and training provided under the Workforce Investment Act, now known as the Workforce Innovation and Opportunity Act (WIOA);
- Obtaining from each eligible entity in the state a community action plan that includes a community needs assessment;
- Ensuring participation by the state and eligible entities in the Results Oriented Management and Accountability (ROMA) system (or an alternative system for measuring performance and results); and
- Not terminating or reducing the CSBG funding of any eligible entity below the proportional share it received the previous year without following certain procedures.³²

Revisions

A state can revise its state plan. Before doing so, however, it must make the revised plan available for public inspection in such a manner as will facilitate review of, and comment on, the plan. It must also submit the revised plan to OCS for its review and approval.³³

G. Uses of CSBG Funds

Buildings and Facilities

The federal CSBG Act generally prohibits the use of CSBG funds for both the purchase and improvement of land and the purchase, construction, or permanent improvement of any building or other facility. However,



there is an exception for low-cost residential weatherization or other energy-related home repairs.³⁴ HHS may waive this prohibition upon a request from a state if HHS finds that the request describes extraordinary circumstances to justify use of the funds for these purposes and that permitting the waiver will contribute to the state's ability to carry out the purposes of the federal CSBG Act.³⁵ OCS [IM 60](#) includes guidance on this prohibition and on the questions to be answered when submitting a request for a waiver. CAAs seeking to use CSBG funds for the purchase of real estate or the construction or permanent improvement of buildings or other facilities should discuss the matter with their state CSBG office before committing CSBG funds to those purposes and, in appropriate cases, work with the state to submit a waiver request to OCS.

CAAs and states should keep in mind that not all building-related expenses are necessarily prohibited under the CSBG Act

CAAs and states should keep in mind that not all building-related expenses are necessarily prohibited under the CSBG Act and that, under the HHS block grant regulations, states have the discretion to decide in the first instance whether an expense is or is not prohibited.³⁶ A waiver is required only if the state decides an expense

is prohibited. For example, a state could reasonably conclude that the CSBG Act does not prohibit the use of CSBG funds for work that can be categorized as allowable maintenance or repair cost under the Uniform Guidance. HHS block grant regulations provide that HHS will defer to a state's interpretation of the federal CSBG act unless that interpretation is clearly erroneous.³⁷ For more information about this prohibition, see CAPLAW's [CSBG Q&A on Property Issues](#).

Political Campaign Activity

The federal CSBG Act contains significant restrictions on involvement by CAAs and their employees in political campaign activity. The Act prohibits a CAA from conducting its programs, using its program funds, providing services, or employing or assigning personnel in a manner that supports or identifies the CAA's CSBG program(s) with:

- Any partisan or nonpartisan political activity or any political activity associated with a candidate, or contending faction or group, in an election for public or party office;
- Any activity to provide voters with transportation to the polls or similar assistance; or
- Any voter registration activity.³⁸

The Hatch Act automatically applies to employees of public CAAs who work in connection with federally financed activities. The CSBG Act also triggers application of the Hatch Act to certain employees of nonprofit CAAs. For more detailed information about the CSBG political campaign activity and Hatch Act restrictions, see *Section G. Political Campaign Activities in Chapter One: General Overview of Federal Grant Law*.





CSBG as Match

The federal CSBG Act is silent regarding the use of CSBG funds as a required match for another federal program. The Uniform Guidance only permits the use of federal funds as a match in certain circumstances. CAA's should use CSBG funds as a match only in accordance with written guidance issued by OCS. OCS IMs [135](#) and [139](#) allow CAAs to use CSBG funds to meet the matching requirements of HUD's McKinney-Vento Homeless Assistance programs and the corporation for National and Community Services' AmeriCorps program, respectively.

Child Support and Drug Treatment Referrals

An often overlooked provision of the federal CSBG Act requires CAAs to inform custodial parents in single-parent families who participate in CSBG programs, activities, or services about the availability of child support services and to refer eligible parents to state and local government child support offices.³⁹ Therefore, a CAA should check that it has procedures in place to make these referrals and, if not, it should implement such a policy. For more information, see CAPLAW's [Q&A on Child Support Referrals](#).

The federal CSBG Act also provides that states may test participants in CSBG-funded programs, activities, or services for controlled substances. States that do this must inform participants who test positive about the availability of treatment or rehabilitation services and refer those participants for appropriate treatment or rehabilitation services. Expenses spent on testing are considered state administrative expenses and are subject to the 5% limit on administrative expenses.⁴⁰

Nondiscrimination and Charitable Choice

The CSBG Act prohibits discrimination in CSBG-funded programs or activities on the basis of race, color, national origin, sex, age, or disability.⁴¹ The CSBG Act's so-called "Charitable Choice" provision specifies that federal, state, and local governments and CAAs must consider religious organizations on the same basis as other nongovernmental organizations when providing CSBG assistance, so long as the program is implemented in a manner consistent with the Establishment Clause of the First Amendment to the United States Constitution. The Establishment Clause generally prohibits the federal government from preferring any one religion over another. Anywhere the term "private, nonprofit organization" is used in the CSBG statute, it includes religious organizations.

A CSBG-funded religious organization is permitted to:

✓	Retain its religious character and control over the definition, development, practice, and expression of its religious beliefs.
✓	Maintain its form of internal governance; except that if it is designated by the state as a CSBG eligible entity, it must conform to the CSBG Act's tripartite board requirements.
✓	Display religious art, icons, scripture, or other symbols.
✓	Make employment decisions on the basis of religion as part of its employment practices.

No CSBG funds provided directly to a religious organization may be used for sectarian worship, instruction, or proselytization and such use must: (i) comply with the same fiscal accountability regulations as other non-profits for the use of the CSBG funds; and (ii) ensure that CSBG funds are placed in a separate account and only those funds are subject to audit by the government. CAAs and other CSBG eligible entities must follow these rules when entering into subcontracts for CSBG programs.⁴²

H. State Allocation Formulas, Payment, and Carryover

State Allocations

Each state allocates its CSBG funding to CAAs through a formula. These formulas vary from state to state and, in some cases, are specified in the state's CSBG laws or regulations. A state can change its formula due to any one of the following:

- the results of the most recently available census or other appropriate data;
- the designation of a new eligible entity; or
- a severe economic dislocation.

However, before it changes its formula, the state must provide CAAs with notice of the proposed change and an opportunity for a hearing on the record concerning the change.⁴³

Carryover

Since federal fiscal year 2002, the federal laws appropriating funds for the CSBG program have contained language providing that:

[T]o the extent [CSBG] funds are distributed ... by a State to an eligible entity ..., and have not been expended by [that] entity, they shall remain with such entity for carryover into the next fiscal year for expenditure by such entity consistent with program purposes.

OCS has interpreted this language to mean that CAAs may carry over CSBG funds from one federal fiscal year (e.g., FY 2015) into the next federal fiscal year (e.g., FY 2016) but must fully expend those funds by September 30 of the second fiscal year (e.g., FY 2016).

Guidance from OCS confirms that this federal appropriations act language supersedes carryover language in the CSBG Act, which authorizes states to recapture and redistribute CSBG funds that a CAA has not obligated at the end of a fiscal year, to the extent that those funds exceed 20% of the funds distributed by the state to the CAA for that year. For more information, see CAPLAW's CSBG [Q&A on Carryover](#).

I. Fiscal Controls and Monitoring

Fiscal Controls

The CSBG Act requires states to establish controls and procedures to assure the proper disbursement of and accounting for CSBG funds, including procedures for monitoring those funds. The CSBG Act also requires states to ensure that OMB's cost and accounting standards apply to recipients of CSBG funds.⁴⁴ For more information about OMB's cost and accounting standards, see the discussion of the Uniform Guidance in *Section B. Overview of Laws and Guidance in Chapter Two: Community Services Block Grant*. In addition, the CSBG Act requires each state to obtain an independent audit of its CSBG funds at least annually.⁴⁵

Monitoring

States are required to conduct a full onsite review of each eligible entity at least once during each three-year period to determine whether it meets the performance goals, administrative standards, financial management requirements, and other requirements of that state. A state must also conduct an on-site review of each newly designated entity immediately after completion of the first year in which the entity receives CSBG funds. It must also conduct follow-up reviews, including prompt return visits, to those entities that fail to meet the goals, standards, and requirements established by the state, as well as other reviews as appropriate, including reviews of entities with programs that have had other federal, state, or local grants terminated for cause.⁴⁶ For more information about the CSBG monitoring processing, see CAPLAW's and the National Community Action Partnership's [Monitoring Map for CAAs: A Guide for Navigating the Monitoring Review Process](#).

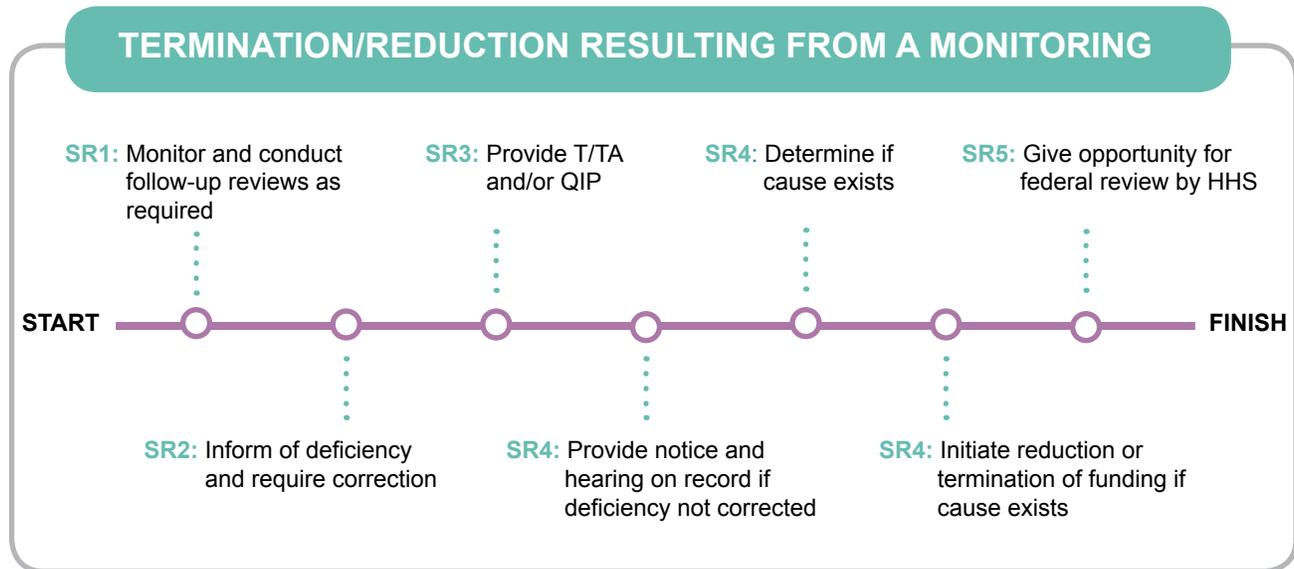
J. Funding Reduction and Termination

Overview

The federal CSBG Act provides CAAs with procedural protections that are somewhat unusual for subrecipients of block grant funds. In particular, a state cannot terminate or reduce a CAA's CSBG funding below the proportional share the CAA received in the previous year without following certain procedures. Until the termination procedures are complete, the state must continue to provide funding to the CAA.⁴⁷ If the state terminates or reduces a CAA's funding without following these procedures, a CAA can request direct funding from OCS.⁴⁸ Thus, a CAA retains its status as an eligible entity until it voluntarily gives up that status or until the state terminates that status by following the required termination procedures. Both OCS [IM 116](#) and CAPLAW's and the National Community Action Partnership's [Monitoring Map for CAAs: A Guide for Navigating the Monitoring Review Process](#) provide information on the procedures for funding terminations or reductions.

Procedures

A funding termination or reduction generally results from either a monitoring or a statewide redistribution of funds. The procedures for a termination or reduction resulting from a monitoring are detailed below.



State Responsibility (SR) 1:	The state monitors a CAA and conducts follow-up reviews as required.
SR 2:	The state notifies an eligible entity of specific deficiencies and corrective action requirements.
SR 3:	The state offers training and technical assistance (T&TA), if appropriate and submits a report to OCS describing the T&TA provided. If the state determines that T&TA is not appropriate, it submits a report to OCS explaining its position. OSC IM 116 provides examples of situations when T&TA may not be appropriate. The state may, at its discretion, provide the eligible entity with an opportunity to correct its deficiencies and implement a quality improvement plan (QIP) to correct them, within 60 days of being informed of the deficiency. Within 30 days of receiving the proposed QIP, the state must approve the QIP or specify reasons why it is not approving the QIP. OCS IM 116 provides examples of situations when a QIP may not be appropriate.
SR 4:	If the eligible entity does not correct the deficiency, the state notifies the eligible entity of the opportunity to request a hearing on the record to determine if cause for termination or a funding reduction exists. OCS IM 116 notes that this requirement may not be waived. Further, according to OCS IM 116 , the hearing procedures must be consistent with any applicable state laws, rules, or policies. If, after the hearing, the state finds cause exists, it initiates proceedings to terminate or reduce CSBG funding.

SR 5:

The state notifies the eligible entity and OCS that it has found cause and that it intends to terminate or reduce the CAA's funding. The state must also notify the eligible entity that the CAA may seek OCS's review of the state's determination by writing to OCS within 30 days of notification of the state's decision. If the eligible entity does not seek OCS review, the state may terminate or reduce the eligible entity's funding. Otherwise, the state must continue both current and future funding of the entity until the later of (i) approval from OCS of the termination or reduction decision, or (ii) passage of 90 days from the date the state provided complete documentation of its decision to OCS. If OCS denies approval of the state's decision, the state must continue funding the eligible entity.

If a state discontinues or reduces funding pursuant to a monitoring without following these steps, the eligible entity may request direct funding from OCS. In that case, the state's block grant would be reduced by the amount of the direct funding.⁴⁹

If a state reduces the proportional share of CAA's funding as a result of a statewide redistribution of CSBG funds, it must show that cause exists to do so. The CSBG Act explains that a statewide redistribution of funds may be needed to respond to (i) the results of the most recently available census or other appropriate data; (ii) the designation of a new CAA; or (iii) severe economic dislocation. The state is required to follow the same procedures it follows for terminating or reducing a CAA's funding pursuant to a monitoring (i.e., provide the CAA with notice, a hearing, and an opportunity for federal review).

According to OCS IM 116, if a state terminates the designation of an organization as an eligible entity or otherwise reduces an eligible entity's CSBG funds, any resulting funding may be awarded only to an organization that is a CSBG eligible entity.

K. Designation of New Eligible Entities

Overview

A state may designate a new eligible entity if an area of the state is not served or ceases to be served by an eligible entity. This includes situations where an existing eligible entity goes out of business, is terminated, or relinquishes its designation as an eligible entity.⁵⁰ OCS [IM 116](#) clarifies that, where a state has made a decision to terminate an eligible entity's CSBG funding and the entity has appealed that decision to OCS, the state can solicit applications for new eligible entities, but cannot award funds to a new entity until OCS confirms the state's decision to terminate or the review period ends.

A state may designate a new eligible entity if an area of the state is not served, or ceases to be served, by an eligible entity.

Criteria

In designating a new eligible entity, a state must choose an organization that has demonstrated effectiveness in meeting the goals and purposes of the CSBG Act. In the designation process, states may give priority to existing eligible entities providing related services in the unserved area, consistent with needs identified by a community needs assessment. In choosing a new eligible entity, a state must first look to nonprofit organizations, as opposed to government entities.⁵¹

New Nonprofit Entities

A state may choose from among two types of nonprofit organizations. It may choose either:

A nonprofit organization...	A nonprofit CAA...
geographically located in the unserved area;	geographically located in an area contiguous to or within reasonable proximity of the unserved area;
+	+
capable of providing a broad range of services designed to eliminate poverty and foster self-sufficiency; and	already providing related services in the unserved area; and
+	+
meeting the requirements of the CSBG Act (including the tripartite board requirement). ⁵²	that will agree to add board members to ensure compliance with the CSBG Act’s tripartite board requirement. ⁵³

New Public Entities

Only if the state concludes that no such nonprofit organizations are qualified may the state consider designating a local government entity.⁵⁴ This local governmental entity must have a tripartite board or other mechanism specified by the state to assure decision-making and participation by low-income people in the development, planning, implementation, and evaluation of the entity’s CSBG programs.⁵⁵

L. Complaint Process

Requirements

The federal CSBG Act requires HHS to respond in an “expeditious and speedy” manner to complaints of a serious nature that a state has failed to use funds in accordance with the CSBG Act, including the required assurances the state has made in its state plan.⁵⁶

HHS block grant regulations provide that in resolving any issue raised by a complaint or a federal audit, HHS will defer to a state’s interpretation of its assurances and of the provisions of the block grant statute unless the state’s interpretation is clearly erroneous. The regulations require that HHS provide copies of complaints

about a state to the state’s independent auditor. They also explain that any determination by HHS that a state’s interpretation is not clearly erroneous is not meant to prevent the auditor from, or influence the auditor in, considering the issue.⁵⁷

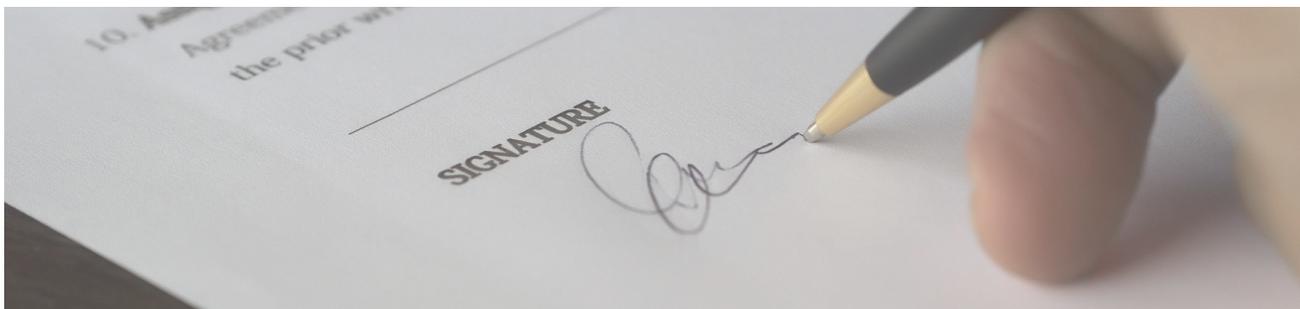
Whenever HHS determines that, for a particular fiscal year, there is a pattern of complaints of a state’s failure to use funds in accordance with the CSBG Act or comply with the state’s assurances, the CSBG Act requires that HHS conduct an investigation as to the state’s use of its CSBG funds.⁵⁸

Process

HHS block grant regulations specify that OCS must process complaints according to the following procedures:

Complaint Process	
✓	First, complaints must be in writing and sent to the director of OCS.
✓	Second, OCS must promptly furnish a copy of any complaint to the affected state.
✓	Third, the state has an opportunity to respond to the complaint. The regulations specify that OCS will consider any comments received from the state within 60 days (or a longer period as agreed to by the state and OCS).
✓	Fourth, OCS will conduct an investigation of complaints where appropriate.
✓	Fifth, OCS will provide a written response to complaints within 180 days of receipt. If a final resolution cannot be provided at that time, the response will state the reasons why additional time is necessary. ⁵⁹

If HHS determines that a state has not used CSBG funds in accordance with the federal CSBG Act or with the assurances made in the state plan, it may withhold funds from the state. However, HHS must first provide adequate notice and an opportunity for a hearing conducted in the state in question. Where amounts are found not to have been spent in accordance with the CSBG Act, the state must repay the funds or HHS may offset the funds against other CSBG funds it pays to the state.⁶⁰



Notes

¹ President Lyndon B. Johnson Special Message to Congress Proposing a Nationwide War on the Sources of Poverty, March 16, 1964

² *Id*

³ See Robert F. Clark, *Maximum Feasible Success: A History of the Community Action Program*, (National Association of Community Action Agencies, 2000), 104 (stating that San Francisco’s mayor John F. Shelley charged that the OEO was “undermining the integrity of local government” and that New York mayor Robert Wagner testified before Congress that local governments should have “power over the ... planning group,” citing J.C. Donovan, *The Politics of Poverty*, 55 (New York: Pegasus, 1967).

⁴ National Association for State Community Services Programs, *CSBG Annual Report 2014*

⁵ 42 U.S.C. § 9901, et seq.

⁶ 42 U.S.C. § 9916(a)(1)(B)

⁷ 2 C.F.R. § 200.101(d)

⁸ 42 U.S.C. § 9907(a)(1)

⁹ 42 U.S.C. § 9915

¹⁰ 42 U.S.C. § 9908

¹¹ 42 U.S.C. § 9907(b)

¹² 42 U.S.C. § 9921

¹³ 42 U.S.C. § 9901

¹⁴ 42 U.S.C. § 9902(2)

¹⁵ 42 U.S.C. § 9910

¹⁶ 42 U.S.C. § 9837(c)

¹⁷ 24 C.F.R. § 92.2

¹⁸ 42 U.S.C. § 9910(a)(1)

¹⁹ 42 U.S.C. § 9910(a)(2)

²⁰ 42 U.S.C. § 9910(a)(2)

²¹ 42 U.S.C. § 9910(a)(2)(A)

²² 42 U.S.C. § 9910(a)(2)(B)(ii)

²³ 42 U.S.C. § 9910(a)(2)(A)

²⁴ 42 U.S.C. § 9910(a)(2)(A)

²⁵ 42 U.S.C. § 9908(a)(2)(C)

²⁶ 42 U.S.C. § 9908(b)(10)

²⁷ 42 U.S.C. § 9908

²⁸ 42 U.S.C. § 9908(a)(2)

²⁹ 42 U.S.C. § 9908(a)(3)

³⁰ 42 U.S.C. § 9908(b)

³¹ 42 U.S.C. § 9908(b)

³² 42 U.S.C. § 9908(b)

³³ 42 U.S.C. § 9908(e)

³⁴ 42 U.S.C. § 9918(a)(1)

³⁵ 42 U.S.C. § 9918(a)(2)

³⁶ 45 C.F.R. § 96.30

³⁷ 45 C.F.R. § 96.50(e)

³⁸ 42 U.S.C. § 9918(b)

³⁹ 42 U.S.C. § 9919(b)

⁴⁰ 42 U.S.C. § 9919(a)

⁴¹ 42 U.S.C. § 9918(c)

⁴² 42 U.S.C. § 9920

⁴³ 42 U.S.C. § 9909(c)

⁴⁴ 42 U.S.C. § 9916(a)(1)

⁴⁵ 42 U.S.C. § 9916(a)(2)

⁴⁶ 42 U.S.C. § 9914

⁴⁷ 42 U.S.C. § 9908(b)(8)

⁴⁸ 42 U.S.C. § 9915(c)

⁴⁹ 42 U.S.C. § 9915(c)

⁵⁰ 42 U.S.C. § 9909

⁵¹ 42 U.S.C. § 9909

⁵² 42 U.S.C. § 9909(a)(1)(A)

⁵³ 42 U.S.C. § 9909(a)(1)(B)

⁵⁴ 42 U.S.C. § 9909(c)

⁵⁵ 42 U.S.C. § 9910(b)

⁵⁶ 42 U.S.C. § 9916(b)(2)

⁵⁷ 45 C.F.R. § 96.50

⁵⁸ 42 U.S.C. § 9916(b)(3)

⁵⁹ 45 C.F.R. § 96.50

⁶⁰ 45 C.F.R. § 96.51

Chapter Three: Financial Management of Federal Grants

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Chapter Three

Financial Management of Federal Grants

A. Introduction

Ensuring that a CAA is financially sound and compliant is one of the most important responsibilities of both the board of directors and the executive management team. All current and potential funding sources of a CAA will want assurances that their funds are being managed and used properly. Thus, the CAA board and executive management team must develop a working knowledge of the requirements that govern the funds received from each of their different funding sources as well as those requirements that govern unrestricted funds generated by the CAA via other means such as fundraising events, private donations, or earned income ventures.

This chapter of the Guide focuses on the federal financial management requirements applicable to the federal grant funds CAAs receive. The intent of this Guide is not to educate the board and executive director on all that they need to know regarding these requirements, but rather to help them understand the framework within which they will oversee and execute a CAA's financial management. By empowering them with this level of knowledge, the CAA leadership should be able to make more informed decisions and recognize when they may need additional information and guidance.

As for funds that originate with the state, a CAA should review state laws, regulations, and contract terms and may need to work with a financial professional or attorney in its state to ensure compliance with the specific laws that govern those funds. It is important to note that funds that pass through the state, such as Community Service Block Grant (CSBG) funds or Low-income Home and Energy Assistance Program (LIHEAP) funds, may be subject to both state and federal grant requirements.

B. Legal Framework of Federal Grant Compliance

Whether establishing financial systems or assessing compliance with the financial management requirements, a CAA's executive management will, in most cases, need to review the following:

- Notice of funding award (NOFA);
- Funding source agreement;
- Office of Management and Budget's (OMB) Uniform Guidance (or a federal agency's own version of the Uniform Guidance);
- Federal program authorizing;
- Federal program regulations, if any exist;
- Federal funding source guidance, if any exists; and
- For block grants, laws and/or regulations promulgated by the state related to the federal funding.



The NOFA and the funding source agreement should include citations to the federal financial management requirements that a recipient will need to comply with, such as the applicable sections of the Uniform Guidance, funding source statutes and regulations, and any applicable state laws. It is important for both the board and executive management team to understand that not all of the requirements listed above will be applicable in every federal funding situation.

For example, the applicability of the Uniform Guidance to specific federal funding sources will vary depending on the nature of the funding. In general, only a few, very specific sections of the Uniform Guidance apply to most block grants because the nature of a block grant is that the state serves as a pass-through entity for the federal funding. Thus, the state has discretion to interpret the federal block grant statute and to promulgate statutes, rules, and guidance related to the funding it passes through. However, the Uniform Guidance may be incorporated by reference in the federal legislation establishing the funding and as a result, recipients of those funds may be required to comply with additional sections of the Uniform Guidance. Federal program statutes and regulations (e.g., Head Start regulations specifying how Head Start funds are to be spent) will trump the Uniform Guidance provisions on those matters. More information regarding the applicability of the Uniform Guidance to different types of grants is available in *Section D. Applicability of Uniform Guidance* below. Even if the Uniform Guidance is not referenced in the funding source statute or regulations, it may still be applicable to the grant funds via the grant agreements awarding the funds to the CAA. Therefore, ensuring that executive management staff have read the NOFA and funding agreement and noted all of the requirements referenced will be the crucial first step to developing and maintaining a strong financial management system.

C. Brief History of Uniform Guidance

In December 2014, OMB issued a set of final regulations that made significant changes to the rules governing how CAAs, states, and other entities receiving federal grants spend and administer their federal funds. These rules, officially titled “Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards,” are informally known as the “OMB Super Circular,” the “Omni Circular,” or the “Uniform Guidance.” For purposes of the Uniform Guidance, the term “federal award” includes federal grants, cooperative agreements, and other agreements for federal assistance, such as loan agreements. (This Guide uses the term “federal grant” interchangeably with the term “federal award.”) Federal awarding agencies adopted regulations implementing the Uniform Guidance by December 26, 2014.¹ The Uniform Guidance’s administrative requirements and cost principles will apply to new federal awards issued by federal awarding agencies on or after December 26, 2014. If federal awarding agencies consider incremental funding actions on previously made awards to be opportunities to change award terms and conditions, the Uniform Guidance requirements will also apply to a funding increment issued on or after December 26, 2014.²

The Uniform Guidance supersedes and streamlines requirements from the following OMB Circulars applicable to the administration, use, and audit of federal grant funds by nonprofit organizations, state, local, and tribal governments, and colleges and universities:

- A-122 (Cost Principles for Non-Profit Organizations);
- A-87 (Cost Principles for State, Local and Indian Tribal Governments);
- A-21 (Cost Principles for Educational Institutions);
- A-110 (Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Non-Profits);
- A-102 (Grants and Cooperative Agreements with State and Local Governments);
- A-89 (Federal Domestic Assistance Program Information);
- A-133 (Audits of States, Local Governments and Non-Profit Organizations); and
- A-50 (Audit Follow-Up).³

The Council on Financial Assistance Reform (COFAR), which is the interagency group of executive branch officials established to develop and oversee the Uniform Guidance, has created resources, including a regularly updated set of FAQs, available on COFAR’s [website](#) to help address many of the issues raised by the creation and implementation of the Uniform Guidance.

D. Applicability of Uniform Guidance

The Uniform Guidance applies to both the federal agencies that make federal awards as well as to non-federal entities (such as states or CAAs) that receive federal grant funds. Under the Uniform Guidance, a non-federal entity receiving federal grant funds may be a direct recipient, subrecipient, and/or pass-through entity. Any non-federal entity that provides a subaward to a subrecipient to carry out part of a federal program is considered a pass-through entity. Thus, in some cases, a CAA may be a recipient or a subrecipient; in other cases, it may be a pass-through entity.

Examples:			Non-Federal Entities		
Direct Recipient		Subrecipient		Pass-Through Entity	
A state receiving Weatherization Assistance Program funds from the U.S. Department of Energy		A CAA receiving CSBG funds from a state		A state CSBG agency granting CSBG funds to a CAA	
A CAA receiving Head Start funds directly from the U.S. Department of Health and Human Services’ Administration for Children and Families.		A delegate agency receiving Head Start funds from a CAA		A CAA grantee granting a subaward of Head Start funds to a delegate agency	

Different rights and responsibilities apply to non-federal entities depending on whether they are recipients, subrecipients, or pass-through entities. Pass-through entities are required to follow the Uniform Guidance provisions specifically applicable to pass-through entities, but not the requirements directed toward federal awarding agencies unless the Uniform Guidance or the terms and conditions of their federal awards specifically indicate otherwise.⁴

The Uniform Guidance's audit requirements apply to all federal awards. However, certain federal programs are exempt from a number of the Uniform Guidance's other requirements.

The Uniform Guidance's audit requirements apply to all federal awards. However, certain federal programs are exempt from a number of the Uniform Guidance's other requirements. For example, except for the requirement to provide public notice of federal financial assistance programs, Subpart C (Pre-Federal Award Requirements

and Contents of Federal Awards) does not apply to entitlement programs such as Medicaid and Temporary Assistance for Needy Families (TANF); entitlement awards under the Commodity Assistance, Summer Food Service Program for Children and the Child and Adult Care Food Program (CACFP); or non-discretionary awards under the Special Supplemental Nutrition Program for Women Infants and Children (WIC), the Emergency Food Assistance Programs, or the Commodity Supplemental Food Program.⁵

By the terms of the Uniform Guidance, block grants authorized under the Omnibus Reconciliation Act of 1981 (including, e.g., CSBG, LIHEAP, the Social Services Block Grant, and federal awards authorized under the Child Care and Development Block Grant Act of 1990) are only subject to the following provisions:

- Acronyms and definitions in Subpart A;
- General provisions in Subpart B;
- Public notice of federal financial assistance programs requirement in Section 200.202 in Subpart C;
- Rules on distinguishing between subrecipients and contractors, pass-through entity/requirements, and fixed amount awards in Sections 200.330 – 200.332 of Subpart D; and
- Single audit requirements in Subpart F.⁶

Unless a federal authorizing statute for the block grant requires compliance with additional sections/subparts and/or a state chooses to voluntarily incorporate by reference additional sections/subparts in its state rules and/or grant agreements, the above provisions are the only Uniform Guidance provisions that will apply to a block grant.

Note, however, that the CSBG Act requires states to ensure that the “cost and accounting standards of the Office of Management and Budget” apply to recipients of CSBG funds.⁷ OMB has interpreted this language to mean that the cost principles of the Uniform Guidance (Subpart E) apply to CSBG grant recipients. Thus, with respect to its CSBG funds, a CAA must comply with the federal cost principles (Subpart E of the Uniform Guidance) in addition to the Uniform Guidance provisions listed above that normally apply to all block grants. If the state wants its CAAs to comply with other provisions of the Uniform Guidance, including the uniform administrative requirements in Subparts C and D with respect to CSBG funds, it can do so by incorporating those provisions of the entire Uniform Guidance by reference in the CSBG grant agreement with the CAA and/or in the state's CSBG statutes and regulations, if any exist.



E. Uniform Administrative Requirements Overview

Subparts C and D of the Uniform Guidance contain the uniform administrative requirements, which set forth the conditions that an entity must meet before and after it receives a federal grant. As explained earlier in *Section D. Applicability of Uniform Guidance of this Chapter Three: Financial Management of Federal Grants*, even though these provisions may not apply to a CAA's CSBG and other block grant funds (e.g., LIHEAP), they may apply to other federal funds a CAA receives.

The pre-award section of the uniform administrative requirements can be found in Subpart C (sections 200.200 through 200.213) and includes requirements and standards regarding:

- Public notice of federal financial assistance programs;⁸
- Federal awarding agencies' announcements for competitive funding opportunities;⁹
- Federal awarding agencies' evaluation of applicants for competitive awards and cooperative agreements on the basis of risk;¹⁰
- Special award conditions that federal agencies may impose based on their risk-based review of funding applicants;¹¹
- Data elements to be included in all federal awards;¹² and
- Public announcement of all federal awards on an OMB-designated government-wide [website](#).¹³

The post-award section of the uniform administrative requirements can be found in Subpart D (sections 200.300 through 200.345) and includes requirements regarding:

- Performance measurement;¹⁴
- Financial management systems;¹⁵
- Effective internal controls;¹⁶
- Interest earned on federal awards;¹⁷
- Criteria for funding source acceptance of shared costs or matching funds and contributions;¹⁸ and
- Use and disposition of supplies and equipment.¹⁹

In the transition from the OMB Circulars to the Uniform Guidance, one of the most significant areas of change has been procurement. The Uniform Guidance provides new, detailed guidance on procurement, which is based mostly on the procurement rules currently applicable to state and local governments. Therefore, for nonprofit organizations, the changes are particularly significant. The procurement standards can be found in sections 200.317 through 200.326, and delineate the following:

- General procurement standards;²⁰
- Specific methods of procurement;²¹
- Requirements around contracting with small and minority businesses, women’s business enterprises, and labor surplus area firms;²²
- A provision prescribing when a cost or price analysis is required;²³ and
- A requirement that a non-federal entity must make available certain information and records regarding a procurement for pre-procurement review upon request by the federal awarding agency or pass-through entity.²⁴

The Uniform Guidance contains special requirements for pass-through entities. These requirements are found in section 200.331, and include a requirement that a pass-through entity must ensure that every subaward is clearly identified to the subrecipient as a subaward and includes certain specified information and requirements. Perhaps the most significant piece of required information is the applicable indirect cost rate for the subaward. If a subrecipient has a federally negotiated indirect cost rate (FNICR) recognized by the federal government, the pass-through entity must recognize that rate. For a subrecipient without an FNICR, the pass-through entity must generally let the subrecipient use an indirect cost rate that is 10% of modified total direct costs (the Uniform Guidance calls this rate a “de minimis” indirect cost rate) or negotiate a higher rate, unless the subrecipient asks to negotiate a lower rate.²⁵ Organizations that make subawards to other entities will need to update their standard subaward document(s) to include this required information. (Cost allocation plans are still an option under the Uniform Guidance. See a discussion on cost allocation plans in *Section H. Federal Cost Principles Under the Uniform Guidance*.)

Additional Pass-Through Entity Obligations	
✓	Evaluate a subrecipient’s risk of noncompliance for purposes of determining the appropriate level of monitoring.
✓	Consider imposing specific subaward conditions.
✓	Monitor a subrecipient’s activities as necessary to ensure that the subaward is used for authorized purposes in compliance with federal statutes, regulations, and terms and conditions of the subaward, and that subaward performance goals are achieved.
✓	Verify that the subrecipient is audited as required by Subpart F of the Uniform Guidance.
✓	Consider whether the results of a subrecipient’s audits, on-site reviews, or other monitoring indicate conditions that necessitate adjustments to a pass-through entity’s records.
✓	Consider taking enforcement action against a noncompliant subrecipient.

The final sections of the uniform administrative requirements cover a number of topics that are not addressed in detail in this Guide. However, these topics (which include requirements for reporting on real property, retention of and public access to records, noncompliance sanctions and termination proceedings, and

closeout procedures) are of importance to CAAs and can be found in sections 200.327 – 200.345. In addition, an overview of rules on working with subrecipients is contained in *Section E. Subrecipient and Contractor Determinations* in *Chapter One: General Overview of Federal Grant Laws*.

F. Financial Management Systems Under the Uniform Administrative Requirements

A CAA's executive management team is charged with creating processes and procedures that ensure that the CAAs financial management systems meet the standards set forth in the Uniform Guidance, while the board exercises oversight over the implementation and maintenance of such systems. This section briefly addresses the general requirements for a federal grantee's financial management systems and then focuses on two major components of such systems: internal controls and procurement. As explained earlier in *Section D. Applicability of Uniform Guidance* of this *Chapter Three: Financial Management of Federal Grants*, even though these provisions may not apply to a CAA's CSBG and other block grant funds (e.g., LIHEAP), they may apply to other federal funds a CAA receives.

Financial Management

The Uniform Guidance sets forth the following characteristics of financial management systems that it expects entities receiving federal funds to incorporate:

- Identification, in its accounts, of all federal awards received and expended and the federal programs under which they were received;
- Accurate, current, and complete disclosure of the financial results of each federal award or program in accordance with the reporting requirements set forth in sections 200.327 (Financial Reporting) and 200.328 (Monitoring and Reporting Program Performance);
- Records that adequately identify the source and application of funds for federally funded activities, including information pertaining to federal awards, authorizations, obligations, unobligated balances, assets, expenditures, income and interest, and source documentation;
- Adequate safeguards for all assets and property and assurances that they are used solely for authorized purposes;
- Comparison of expenditures with budgeted amounts for each federal award;
- Written procedures to implement the requirements relating to payments in section 200.305 (Payment); and



- Written procedures for determining the allowability of costs in accordance with Subpart E (Cost Principles) and award terms and conditions.²⁶

Internal Controls

Under the Uniform Guidance, recipients and subrecipients of federal grants are required to maintain a system of internal controls that provide “reasonable assurance that the non-federal entity is managing the Federal award in compliance with Federal statutes, regulations, and the terms and conditions of the Federal award.”²⁷ The regulations do not provide detailed guidance as to the content of the controls, but direct non-federal entities to the following for guidance in establishing compliant internal control systems: (i) the [Standards for Internal Control in the Federal Government](#) issued by the Comptroller General of the United States and known as the “Green Book,” or (ii) the [Internal Control Integrated Framework](#), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, CAPLAW’s [Exemplary Legal Practices and Policies Guidebook](#) offers guidance for establishing an internal controls structure based on the practices of CAAs nationwide.

Generally speaking, internal controls are an organization’s processes that provide reasonable assurance regarding the accomplishment of an entity’s goals or objectives in operations, reporting, and compliance. These processes include the organization’s governance, corporate structure, work flows, people, policies, procedures, and information systems. Having sound internal controls means these processes are directed, monitored, and measured. Frequently, internal controls are key in preventing and detecting fraud and protecting an entity’s assets.²⁸

Both the Green Book and the COSO framework consider internal controls in five main components: control environment, risk assessment, control activities, information and communication, and monitoring. The first, and most general, is the control environment. It is the foundation of an internal control system and it provides the discipline and structure for that system.²⁹

PRACTICE TIPS

Ways to Ensure a Strong and Effective Control Environment

Visible commitment to compliance and high ethical standards by the organization’s board and senior management;

Creation and enforcement of essential organizational policies and procedures regarding conflicts of interest, whistleblowers, and code of ethics;

Communication of the organization’s commitment to compliance and ethical behavior through various means, such as memos, emails, newsletters, the organization’s internal website, meetings, and trainings;

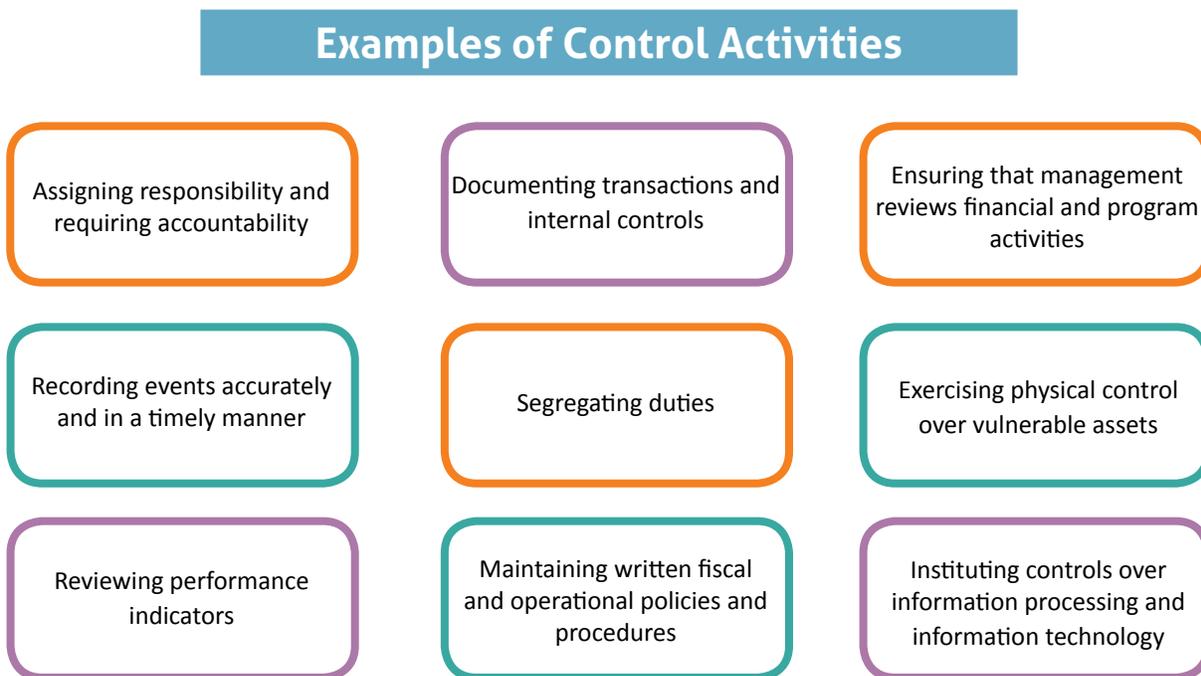
Prioritizing ethics and compliance in hiring and evaluating the executive director;

Board review of monthly financial statements, compensation and management capacity, resolution of audit and monitoring findings, and programmatic accomplishments; and

Regular board communication with the board’s audit committee or the organization’s external auditor.

Once a CAA has established an effective internal control environment, the CAA’s management should assess the risks that the organization faces, both from internal and external sources. This assessment will form the basis for developing appropriate risk responses.³⁰ It is critical to look at the organization as a whole, rather than as a collection of individual programs, when assessing risk. A CAA can gather information on its ethical climate through means such as: informal discussions with board members, staff, volunteers, and clients; exit interviews with departing employees; client feedback and complaints; and social media feedback from members of the public. A general risk assessment should involve a review of external risks such as the funding environment, community perception, and the changing demand or need for services. A review of internal risks should include identifying the risks associated with ensuring compliance with funding source requirements as well as other requirements that govern an organization’s operations, such as employment laws and, for nonprofit CAAs, 501(c)(3) tax-exempt rules. Other legal risks to assess could include potential liability from personal injury, contract, or privacy-related lawsuits. Senior management and boards should receive regular updates of both internal and external risks and conduct an exposure analysis, or a ranking of risks by significance of potential losses and likelihood of occurrence.

The third component of internal controls is control activities, which are the policies and procedures created by CAA management to achieve objectives and respond to risks in the internal control system.³¹



In the next component of internal controls, management uses information to support the internal control system. Because effective information and communication are vital for a CAA to achieve its objectives, management needs access to relevant and reliable communication related to internal and external events.³² This can be achieved through monthly financial reporting and accomplishment reporting at the program and organizational level; providing managers access to operational and financial data as needed for planning and oversight; and creating structures, policies, and procedures to encourage open information flow among all levels of the organization.

The final component of an internal control system is monitoring. Implementing an internal control system should be a dynamic process that continually adapts to the risks and changes a CAA faces. Monitoring the

internal control system is essential in helping internal controls remain aligned with changing objectives, environment, laws, resources, and risks. Internal control monitoring assesses the quality of performance over time and promptly resolves the findings of audits and other reviews.³³

Examples:	Monitoring Activities
	Comparing planned program and financial activity to actual activity on a monthly basis.
	Developing systems for tracking all audit and monitoring findings and their correction or resolution.
	Clearly assigning responsibility for correcting or resolving findings and regularly overseeing progress in doing so.
	Ensuring that financial and program data reports are routinely completed and reviewed by managers.

Procurement

The Uniform Guidance provides detailed rules on procurement procedures for federal grantees. In the transition from the OMB Circulars to the Uniform Guidance, many of the procurement rules that were previously applicable to state and local governments were made applicable to nonprofit organizations. CAAs should carefully review their current procurement policies against the rules in sections 200.317 through 200.329 to determine whether any revisions to their policies will be necessary or desirable. Where an organization's procurement policy is more permissive than the Uniform Guidance requirements, the Uniform Guidance will govern; however, where the organization's policy is more restrictive than the Uniform Guidance, the policy will govern.

The Uniform Guidance permits non-federal entities to delay implementation of the new procurement rules for two additional fiscal years after December 26, 2014. For example, a CAA with a fiscal year beginning July 1, 2015 is not required to adopt the procurement standards in the Uniform Guidance until the fiscal year





beginning July 1, 2017.³⁴ CAAs and other CSBG network organizations choosing to delay implementations of the Uniform Guidance procurement standards must document this decision in their internal procurement policies.

All procurement transactions must be conducted in a manner involving full and open competition. Actions that will be considered an inappropriate restriction on competition include: (i) requiring unnecessary experience and excessive bonding; (ii) placing unreasonable qualification requirements on firms that wish to do business with the organization; (iii) noncompetitive pricing practices between firms or between affiliated companies; (iv) noncompetitive contracts to consultants on retainer; (v) organizational conflicts of interest; (vi) requiring exclusively “brand name” products where “an equal” alternative product exists; and (vii) arbitrary actions during the procurement process.³⁵

Non-federal entities are required to maintain written standards of conduct covering conflicts of interest and governing the actions of their employees engaged in the award, selection, or administration of a procurement contract. A conflict of interest exists when such an employee, officer or agent, or any of his/her related parties (e.g., any member of his or her immediate family, his or her partner, or an organization which employs or is about to employ any of such related parties), has a financial or other interest in a firm considered for the contract.

The standards of conduct covering conflicts of interest must:	
	Provide for disciplinary actions for violations;
	Bar employees, officers, and agents from participating in the selection, award, or administration of a contract if they have an actual or apparent conflict of interest;
	Prohibit officers, employees, and agents of the non-federal entity from soliciting or accepting gratuities, favors, or anything of monetary value from contractors or parties to subcontracts (except for situations where the financial interest is not substantial or the gift is an unsolicited item of nominal value); and
	Cover organizational conflicts of interest if the non-federal entity has a parent, affiliate, or subsidiary organization that is not a state, local government, or Indian tribe. ³⁶

Non-federal entities must also have written procurement procedures that require them to avoid purchasing unnecessary or duplicative items and to conduct an analysis of leasing and purchasing alternatives.

All procurement solicitations must include:	
✓	A clear and accurate description of the technical requirements of the material, product, or service to be purchased. (Note that in competitive procurements, the description cannot contain features which unduly restrict competition);
✓	Any specific features of “brand name or equivalent” descriptions;
✓	The requirements which the bidders must fulfill; and
✓	All other factors to be used in evaluating bids or proposals.

Non-federal entities are required to take all necessary affirmative steps to assure that minority businesses, women’s business enterprises and labor surplus area firms are used when possible. This may include: (i) putting such businesses on solicitation lists; (ii) assuring that such businesses are solicited whenever they are potential sources; (iii) dividing total requirements to permit maximum participation of such businesses; (iv) establishing delivery schedules which encourage participation by such businesses; and (v) requiring the prime contractor in subcontracting arrangements to take these affirmative steps.³⁷

The Uniform Guidance outlines the following permissible methods of procurement:³⁸

In Detail

Micro-Purchases

Procurement of supplies or services for which the aggregate dollar amount does not exceed the micro-purchase threshold specified in the Federal Acquisition Regular (FAR) as 48 C.F.R Subpart 2.1 (\$3,500 for 2016³⁹ or \$2,000 in the case of construction projects subject to the Davis-Bacon Act) may be conducted without soliciting competitive quotations if the non-federal entity considers the price to be reasonable. Micro-purchases should be distributed equitably among qualified suppliers. For example, a bulk purchase of paper in the amount of \$2,000 can be treated as a micro-purchase for which no competitive rate quotations are necessary and no cost or price analysis is required. However, in accordance with the non-federal entity’s written policies, which may include strategic sourcing or bulk purchase arrangements, the non-federal entity must consider whether to make the purchase from any one of a number of office supply vendors. The non-federal entity’s policies may require that the purchase of office supplies rotate among qualified suppliers if they offer the same rates. The micro-purchase threshold specified in 48 C.F.R. Subpart 2.1 is periodically adjusted for inflation.

Small Purchases

A simplified procurement process is permissible for purchases of services, supplies, or property that do not exceed the “Simplified Acquisition Threshold,” which has been increased to \$150,000 and which will be adjusted for inflation. In such procurement, a grantee must obtain price or rate quotes from an adequate number of qualified sources. Non-federal entities should specify in their written procurement policies what they consider to be an “adequate” number of sources and how price

or rate quotations are to be obtained (e.g., in writing, orally, from a vendor price list on a website, or via an online search). A cost or price analysis is not required under small purchase procedures. For example, a purchase order for insulation supplies in the amount of \$10,000 for a CAA's weatherization program can be treated as a small purchase order. This purchase order requires a rate quote from at least two sources, which may be obtained in writing from two suppliers or by research done on public websites.

Sealed Bids (Formal Advertising)

For procurement transactions that will exceed the Simplified Acquisition Threshold, a non-federal entity may use the sealed bidding method to publicly solicit and award a firm, fixed price contract (lump sum or unit price) to a responsible bidder whose bid conforms to all the material terms and conditions of the solicitation and is the lowest in price. For sealed bidding to be feasible, the following conditions must exist:

- A complete, adequate, and realistic specification or purchase description is available;
- Two or more responsible bidders exist; and
- The procurement need lends itself to a firm, fixed price contract and the selection of a bidder can be made principally on the basis of price.

Where these conditions exist, sealed bidding is the preferred method for procuring construction. If the sealed bid method is used: (i) all bids must be opened at the time and place prescribed in the invitation for bids, and for local and tribal governments, the bids must be opened publicly; (ii) a firm, fixed price contract must be awarded in writing to the lowest responsive and responsible bidder; and (iii) the invitation for bids must:

- Be publicly solicited;
- Be solicited from an adequate number of suppliers;
- Provide sufficient response time prior to the date set for opening the bids, and for local and tribal governments, the invitation for bids must be publicly advertised;
- Include all specifications and pertinent attachments; and
- Define the items or services needed for the bidder to properly respond.

Notwithstanding the requirements above, a grantee may reject any or all bids if it has a sound, documented reason for doing so.

Competitive Proposals

Where the sealed bid method is not appropriate, a non-federal entity may conduct a competitive proposal process whereby more than one source submits an offer and either a fixed price or cost-reimbursement type contract is awarded to the most responsive offer. If this method is used, then the following requirements apply:

- Requests for proposals must be publicized and identify all evaluation criteria along with their relative importance;

- Any response to the publicized request must be considered to the maximum extent practical;
- Proposals must be solicited from an adequate number of qualified sources;
- The non-federal entity must have a written method for conducting technical evaluations of the proposals received and for selecting contractors; and
- Contracts must be awarded based on price and other factors to the responsible firm whose proposal is most advantageous to the program.

Special rules apply to procurements of architectural or engineering services through the competitive proposal process.

Noncompetitive Proposals (Sole Source Procurement)

The use of noncompetitive proposals are permitted where only one source for procurement is considered and if any one or more of the following situations applies:

- The item is only available from a single source;
- Public exigency or emergency for the required procurement exists and will not permit a delay for competitive solicitation;
- The non-federal entity requested in writing and obtained express authorization from the federal awarding agency or pass-through entity to use sole source procurement procedures; or
- After solicitation of a number of sources, the non-federal entity determined that competition was inadequate.

Whatever method of procurement a CAA uses, it must maintain records sufficient to detail the history of procurement. At a minimum, these records must include the rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price.⁴⁰

G. Notable Financial Provisions in the Uniform Administrative Requirements

Cost sharing/matching and program income are two provisions in the uniform administrative requirements that specifically relate to the financial obligations of federal grant recipients subject to Subpart D (Post-Federal Award Requirements) of the Uniform Guidance. As explained earlier in *Section D. Applicability of Uniform Guidance* of this *Chapter Three: Financial Management of Federal Grants*, even though these provisions may not apply to a CAA's CSBG and other block grant funds (e.g., LIHEAP), they may apply to other federal funds a CAA receives.

Cost Sharing and Matching

Many federal grant programs require cost sharing, or obtaining a certain percentage of program funding from non-federal sources. The determination of the non-federal share will vary by program. The following cost sharing arrangements exist:

Percentage Formulas

With percentage formulas, the award authorizing legislation or implementing regulations set a certain percentage level of program funding that must come from non-federal sources. For example, Head Start specifies that at least 20% of the funding of a Head Start grantee's program must come from non-federal sources, unless a waiver is obtained.

Maintenance of Effort

Some programs require that the grantee maintain a certain level of funding based on its prior expenditures. The same principle is often expressed as a requirement that federal funds be used to supplement, rather than supplant, existing efforts. In either case, the goal is for the organization to use the federal funds to expand its services rather than to replace non-federal funds. The TANF program is an example of a program requiring maintenance of effort.

Cost Sharing Agreements

In some instances, grantees enter into cost sharing agreements with the federal awarding agency that specify the grantee's share of costs or that require the grantee to make certain expenditures.

When satisfying cost sharing requirements, all contributions, including in-kind contributions, are counted towards cost sharing requirements, provided that they meet the following seven conditions:

- Verifiable from the grantee's records;
- Not included as a contribution for another federal award;
- Necessary and reasonable for the accomplishment of the project or program objectives;
- Allowable under the federal cost principles in Subpart E (Cost Principles of the Uniform Guidance);
- Not from another federal award, except as authorized by statute, as further discussed below;
- Included in the approved budget if required by the federal funding agency; and
- Conforms to any other applicable grant management provisions of the federal funding agency.⁴¹

As noted in the above list, funds from another federal award cannot be used for cost sharing or as a match except where the federal statute authorizing a program specifically provides that such federal funds can be applied to matching or cost sharing requirements of other federal programs.⁴² The federal CSBG Act is silent regarding the use of CSBG funds as a required match for other federal programs. However, the federal Office of Community Services (OCS), which administers the CSBG program, has issued guidance stating that CSBG funds may, under certain circumstances, be used to meet matching requirements of the Corporation for National and Community Services AmeriCorps program as well as of McKinney-Vento Homeless Assistance Act programs.⁴³

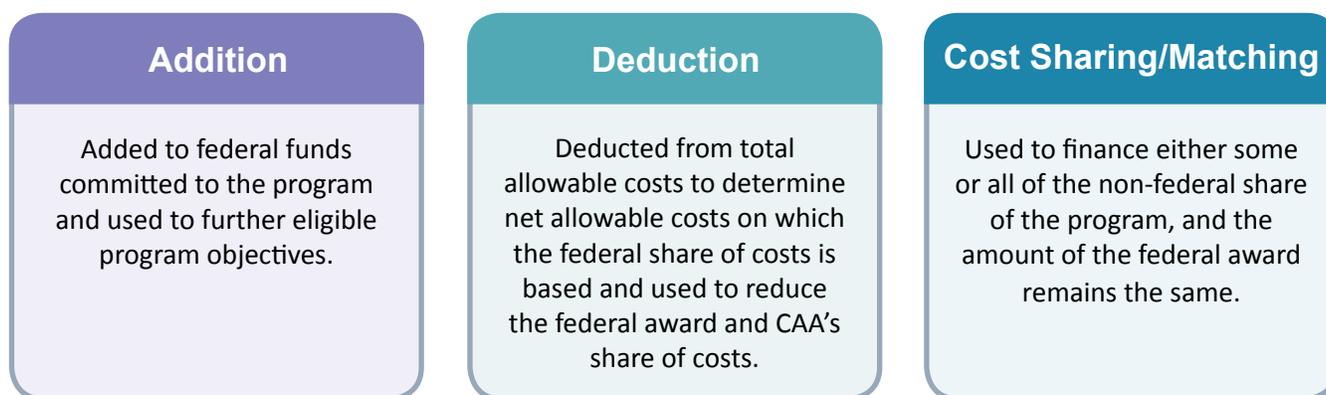
Unrecovered indirect costs, which are indirect costs that exceed the amount allowed to be charged to the federal award under the grantee's approved negotiated indirect cost rate, and which include indirect costs on cost sharing or matching, may be included as part of cost sharing or matching only with the prior approval of the federal awarding agency.⁴⁴

The value of donated services and property may also be used to meet cost sharing or matching requirements.⁴⁵

Program Income

CAAs may generate program income in the course of providing services funded by their federal awards. Program income is gross income earned by the grant recipient that is directly generated by a grant-supported activity or earned as a result of the award. Program income includes, but is not limited to: income from fees for services performed; the use or rental of real or personal property acquired under federal awards; the sale of commodities or items fabricated under a federal award; license fees and royalties on patents and copyrights; and principal and interest on loans made with federal award funds. Program income does **not**, however, include any of the following: rebates, credits, discounts or interest earned on any of such activities; interest earned on advances of federal funds; nor proceeds from the sale of real property, equipment, or supplies.⁴⁶

Program income can be used in one of the following three ways:



If the funding source does not specify, either through regulations or in the award document, which of the above alternatives applies, the deduction alternative will apply by default to a CAA's federal awards. When a funding source authorizes the addition or cost-sharing/matching alternative and specifies limits on the program income that can be used under those alternatives, program income exceeding the limit must be used in accordance with the deduction alternative.⁴⁷

If authorized by federal regulations or the award terms and conditions, the costs of generating program income may be deducted from gross income to determine program income, as long as those costs have not been charged to the federal award.⁴⁸ Unless federal awarding agency regulations or the terms and conditions of the federal award provide otherwise, CAAs have no obligation to the federal government regarding program income earned after the end of the performance period of the award.⁴⁹

H. Federal Cost Principles Under the Uniform Guidance

One of the most important responsibilities of senior management and the board is to ensure that federal funds are properly used to pay for the costs associated with furthering the purposes of the federal award. Most federal grant funds received by a CAA are governed by Subpart E (Cost Principles of the Uniform Guidance), which addresses how a grantee determines which costs may be paid for using federal award funds and the different ways to charge federal awards for such costs. This section of the Guide offers an overview of the general principles that apply to determine if a cost may be charged to a federal award, the ways in which costs may be charged, and some of the costs specifically addressed by the cost principles.



Basic Considerations

When determining if the cost of a good or service is chargeable to a federal award or cost objective in accordance with the relative benefits received, a CAA must consider if the cost: (i) is incurred specifically for a federal award; (ii) can be properly distributed using reasonable methods when it benefits both a federal award and other work; and (iii) is necessary for overall operations and assignable in part to the federal award in accordance with the cost principles. Costs must be adequately documented and treated consistently.⁵⁰ In determining if a cost is reasonable, consideration is given to: whether it is generally recognized as ordinary and necessary to the operation of the CAA or the efficient performance of the federal award; the market price for comparable goods or services for the geographic area; compliance with laws, regulations, and terms and conditions of an award; if the cost results from sound business practices and arm's-length bargaining; whether those who incurred the cost acted with prudence; and any significant deviation from established organizational practices and policies.⁵¹

Generally, costs fall within two categories under the Uniform Guidance: **direct costs** and **indirect costs**.

In Detail

Direct Costs

Costs that are readily identifiable or can be directly assigned to federal grant activities relatively easily with a high degree of accuracy.⁵²

Indirect Costs

Costs incurred for a common or joint purpose benefiting more than one cost objective and are not readily assignable to the cost objectives specifically benefited without effort disproportionate to the results achieved.⁵³ Indirect costs are also referred to as facilities and administration (F&A) costs. However, it is important to note that not all administrative costs charged to a federal award are indirect costs and that the funding source statute and regulations, and not the Uniform Guidance, dictate which costs are subject to an administrative limit or cap, if one exists.

A determining factor in distinguishing direct and indirect costs is the identification of a cost with a federal award rather than with the nature of the goods and services involved. Thus, a cost that is identified with a federal award, such as compensation for an employee who facilitates a job training program funded with CSBG dollars, would most likely be considered a direct cost. On the other hand, a cost associated with a good or service, such as a copier that is used by multiple programs funded by different sources, would likely be an indirect cost. For other costs, the Uniform Guidance either specifically designates them as indirect costs (e.g., proposal costs) or establishes a default treatment for the cost unless certain factors exist. For example, under

the Uniform Guidance, the salaries of administrative and clerical staff are normally treated as indirect costs, but direct charging of such costs is appropriate if all of the following conditions are met:

Direct Charging Conditions for Administrative Staff	
✓	Administrative or clerical services are integral to a project or activity;
✓	Individuals involved can be specifically identified with the project or activity;
✓	Such costs are explicitly included in the budget or have the prior written approval of the federal awarding agency; and
✓	The costs are not also recovered as indirect costs. ⁵⁴

Even though non-federal entities may not shift costs to overcome funding deficiencies or avoid restrictions, the Uniform Guidance permits shifting costs that are allowable under two or more federal awards if existing federal statutes, regulations, or award terms and conditions allow such cost shifting.⁵⁵ If a cost benefits two or more projects or activities in determinable proportions, it should be allocated based on proportional benefit. If a cost benefits two or more projects or activities in non-determinable proportions, it may be allocated or transferred on any reasonable documented basis.⁵⁶ Cost allocation is discussed in greater detail in the subsection below entitled “*Cost Allocation Plans.*”

Options for Recovering Costs

The Uniform Guidance sets forth three options for recovering indirect and/or joint (often referred to as “shared”) costs incurred by a non-federal entity: an FNICR, a cost allocation plan and/or the 10% de minimis rate. The option for recovering indirect costs via an FNICR is available only to a non-federal entity that receives funding directly from a federal agency (e.g., a Head Start grant). It is important to remember that a non-federal entity may only recover costs specifically identified as “indirect” in Subpart E (Cost Principles) of the Uniform Guidance if the grantee has an indirect cost rate—either an FNICR or the de minimis rate. The Uniform Guidance added the third option for recovering indirect costs—using a de minimis rate of 10% of “modified total direct costs”—which is available to non-federal entities that receive direct federal funding and have never previously obtained an FNICR.

For those organizations that either receive funds via a pass-through entity (e.g., a state CSBG office that makes CSBG grants to CAAs) or that act as pass-through entities themselves (e.g., CAAs that make subgrants to Head Start delegate agencies), it is important to note that pass-through entities are now required under the Uniform Guidance to accept a subrecipient’s FNICR, if it has one. For those subrecipients without an FNICR, a pass-through entity must either permit the subrecipient to use the 10% de minimis rate or negotiate a higher rate with the subrecipient (unless the subrecipient voluntarily agrees to take a lower rate or none at all). The pass-through entity cannot force or entice a subrecipient to accept a negotiated rate that is lower than the 10% de minimis rate.⁵⁷

Federally Negotiated Indirect Cost Rate

An FNICR is an agreement between a federal agency and a federal grantee that establishes the maximum amount of indirect costs that the grantee may charge to its federal awards by calculating the organization's indirect costs as a percentage of direct costs. To obtain an FNICR, the grantee must have a direct funding relationship with a federal agency. Grantees seeking FNICRs must determine which of their federal funding sources will serve as their cognizant agency (i.e. the agency that is responsible for negotiating and approving indirect cost rates). The cognizant agency generally is the agency from which the grantee receives the largest amount of direct federal funding.⁵⁸ Information about negotiating FNICRs is included in the Appendices to the Uniform Guidance.

If an organization is able to obtain an FNICR, this rate must be accepted by all of the organization's federal awarding agencies.

Generally for nonprofit organizations, once the organization submits the proposal, the cognizant agency for indirect costs assigns a negotiating officer to work through questions, request modifications of the proposal, and ultimately issue a written acknowledgment of the agreed-upon FNICR in the form of an indirect cost rate agreement. The Uniform Guidance permits multiple approaches to determining indirect cost rates and also describes four distinct types of FNICRs which may be approved by federal agencies. If an

organization is able to obtain an FNICR, this rate must be accepted by all of the organization's federal awarding agencies. A federal agency may only use different negotiated rates when required by federal statute or regulation or when approved by the federal agency head based on documented justification.

A non-federal entity with an FNICR may apply for a one-time extension of that rate for up to four years. The rate must be a current FNICR, which means that it is in effect when a rate extension request is made, and is a "predetermined" or "final" rate. The extension does not apply to "provisional" or "fixed" rates.⁵⁹ Extensions are subject to review and approval. If the extension is approved, the entity may not request a rate review until the end of an extension period, at which time it must re-apply to negotiate a rate. Because the intent behind allowing extensions is to minimize the administrative burden for the non-federal entity, the Uniform Guidance limits the documentation required to support an extension.⁶⁰

10% De Minimis Rate

Non-federal entities that have never received an FNICR have the option to charge a de minimis rate of 10% of modified total direct costs (MTDC), which may be used indefinitely. MTDC is defined as all direct salaries and wages, applicable fringe benefits, materials and supplies, services, travel, and up to the first \$25,000 of each subaward (regardless of the period of performance of the subawards). MTDC excludes equipment, capital expenditures, charges for patient care, rental costs, tuition remission, scholarships and fellowships, participant support costs, and the portion of each subaward in excess of \$25,000.⁶¹ If a non-federal entity chooses the de minimis rate, it must use the rate consistently for all federal awards until it chooses to negotiate an FNICR, which it may apply to do at any time.

Cost Allocation Plan

CAAs without an FNICR, and sometimes in conjunction with an FNICR, are permitted under the Uniform Guidance to recover costs related to the delivery of multiple services funded through multiple funding agreements via a cost allocation plan. As previously mentioned, the Uniform Guidance sets forth the following direct cost allocation principles:



If a cost benefits two or more projects or activities in proportions that can be determined without undue effort or cost, the cost must be allocated to the projects based on the proportional benefit. If a cost benefits two or more projects or activities in proportions that cannot be determined because of the interrelationship of the work involved, then . . . the costs may be allocated or transferred to benefited projects on any reasonable documented basis.⁶²

Costs such as rent for a facility housing multiple programs, a telephone system serving multiple programs, or costs associated with financial management or board support, are often referred to as shared, overhead, or joint costs. To determine what portion of such joint costs are recoverable from multiple funding agreements, a CAA must allocate costs pursuant to a documented basis (e.g., a formula). In other words, the CAA must determine a defensible way to estimate the benefit that each of its distinct program activities or funding source agreements received from the shared costs incurred.

Charging an allocated portion of a joint cost to a specific award also requires that the recipient apply its allocation methods consistently. While CAAs may use various allocation methods to allocate different types of costs, the method used for any one type of cost must be used consistently. Finally, the cost allocation method must not be unreasonably costly to apply. For example, while it is possible to estimate the benefit of the purchase of a ream of copier paper to each cost center by having an employee keep track of the purpose for which each piece of paper is used, this is an unreasonably costly method to allocate the benefit of a relatively small cost.

For more information about developing cost allocation plans, see the national Community Action Partnership resource [Cost Allocation: Red Flags and Remedies](#). Even though this resource is not updated to include citations to the Uniform Guidance, many of the concepts and rules still apply.

Selected Items of Cost

The Uniform Guidance contains a section on selected items of cost that sets forth the principles to apply in determining the allowability of certain items of cost. Note, however, that it is not an exhaustive list. The absence of a particular cost from the list is not intended to imply that the cost is either allowable or unallowable. Whether the cost is allowable should be based on how similar or related items of cost are treated and on the application of the general principles used to determine cost allowability in sections 200.402 through 200.411 of the Uniform Guidance.⁶³

The following is a discussion of a handful of selected items of cost that are of particular importance to CAAs. The full list of items of cost is in sections 200.420 through 200.475 of the Uniform Guidance.

Advertising and Public Relations

These costs are generally unallowable. However, some allowable advertising costs include program outreach, personnel recruitment, procurement, and other specific purposes necessary to meet federal award requirements. Allowable public relations costs include those specifically required by a federal award and those necessary for communicating with the general public and press about specific federal award activities, accomplishments, and matters of public concern.⁶⁴

Audit Services

A CAA may charge “a reasonably proportionate share” of cost involved with performing a Single Audit to its federal awards. Costs associated with the following types of audits are specifically designated as unallowable: (i) audits not conducted in accordance with Single Audit requirements and (ii) audits that fall below the Single Audit threshold. Pass-through entities may charge against the applicable federal award the cost of agreed-upon procedures to monitor subrecipients that are exempt from the Single Audit Act as long as such procedures are conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS), paid for and arranged by the pass-through entity, and limited in scope to one or more of the following types of compliance requirements: allowable activities, allowable costs/cost principles, eligibility, and reporting.⁶⁵

Compensation – Personal Services

The Uniform Guidance made changes that could significantly impact how state and local governments and nonprofits assess, track, and allocate employee compensation costs for purposes of federal awards. As a result, a non-federal entity may adopt incremental or more significant changes that reduce the burden associated with its current system for documenting and charging compensation costs to its federal awards.⁶⁶

Many CAAs are accustomed to tracking employee work time using personnel activity reports (PARs) that were required under the federal cost principles in OMB Circulars A-122 and A-87. The national Community Action Partnership resource, [Personnel Activity Reports: The Do's and Don'ts](#), provides an in-depth discussion of the requirements for maintaining PARs. The Uniform Guidance, however, no longer specifically requires PARs. Rather, non-federal entities may use any method they choose as long as the method:

- Is supported by a system of internal controls which provides reasonable assurance that the charges are accurate, allowable, and properly allocated;
- Is incorporated into the non-federal entity's official records;
- Reasonably reflects the total activity for which the employee is compensated;
- Encompasses all activities – those that are federally assisted and those that are not;
- Complies with the established accounting practices and policies of the non-federal entity; and
- Supports the distribution of the employee's salary or wages among specific activities or cost objectives.⁶⁷

Budget estimates (estimates determined before services are performed) do not qualify as support for charges to a federal award, but may be used for interim accounting purposes if the non-federal entity:

- Has a system that produces a reasonable approximation of actual activity;
- Enters significant changes into records in a timely manner; and
- Follows processes to review after-the-fact interim charges to estimates and ensure that the final amount charged is accurate, allowable, and properly allocated.

The Uniform Guidance also addresses blended funding. For federal awards of similar purpose activity or approved blended funding, a non-federal entity may submit performance plans that incorporate funds from multiple federal awards and account for their combined use based on performance-oriented metrics as long as the plans are approved in advance by all federal awarding agencies involved. A non-federal entity must submit a request for waiver of the documentation standards. The waiver is based on documentation that describes the method of charging costs, relates the charging of costs to the specific activity that is applicable to all funding sources, and is based on quantifiable measures of the activity in relation to time charged.⁶⁸

The Uniform Guidance still refers to PARs as an acceptable way to document staff time and effort spent on federal awards, and a federal agency may still require that a non-federal entity use PARs or equivalent documentation if it finds that the non-federal entity failed to meet the above standards.⁶⁹

Compensation – Fringe Benefits

The cost of fringe benefits is allowable, provided the benefits are reasonable and required by law, employment agreement, or an established policy. The following criteria must be met for leave benefits (e.g., annual, sick, Family and Medical Leave Act, holiday, court, military, administrative, etc.) to be allowable:

- Benefits are provided for under established written leave policies;
- Costs are equitably allocated to all related activities, including federal awards; and
- The accounting basis (cash or accrual) selected for costing each type is consistently followed.

Also, costs of pension plans and post-retirement health plans may be computed using a pay-as-you-go method or an acceptable actuarial cost method in accordance with established written policies.⁷⁰

Employee Health and Welfare Costs

Costs incurred in accordance with the non-federal entity's documented policies for the improvement of working conditions, employer-employee relations, employee health, and employee performance are allowable. Employee morale costs, however, which were an allowable cost under the prior OMB Circulars A-122 and A-87, are no longer specifically allowable under the Uniform Guidance. OMB made this change because it concluded that such costs are difficult to distinguish from entertainment costs and potentially result in opportunities for waste, fraud, and abuse.⁷¹

Entertainment Costs

Generally, entertainment costs are unallowable, but certain costs may be charged to a federal award if they: (i) have a programmatic purpose and (ii) are authorized either in the approved budget or with prior written approval from the federal awarding agency.⁷²

Fines, Penalties, Damages, and Other Settlements

All costs (not just fines and penalties) resulting from alleged and existing violations and failures to comply with laws and regulations are generally unallowable. Such costs are allowable, however, when they are incurred as a result of compliance with federal award provisions or with prior written approval from the federal awarding agency. Thus, CAAs seeking to settle legal claims alleging violations of laws or regulations (e.g., employment discrimination claims) must obtain written prior approval from the federal awarding agency before using federal award funds to settle those claims.⁷³

Fund Raising and Investment Management Costs

Non-federal entities may charge fundraising costs incurred for meeting federal program objectives to a federal award with prior written approval from the federal awarding agency. Costs related to the physical custody and control of monies and securities are also allowable. Costs of investment counsel and staff and similar expenses incurred to enhance income, while generally unallowable, may be charged to federal awards when those costs are associated with investments covering pension, self insurance, or other funds which include federal participation allowed under the Uniform Guidance.⁷⁴

Insurance and Indemnification

Contributions to a reserve for some self-insurance programs (including worker's compensation, unemployment compensation, and severance pay) are allowable if certain conditions are met. Also insurance refunds, if received, must be credited against such costs in the year the non-federal entity receives the refund.⁷⁵

Interest

Financing costs (including interest) to acquire, construct, or replace capital assets are allowable, subject to a number of conditions.⁷⁶

Lobbying

Lobbying costs are generally unallowable, with several relatively narrow exceptions applicable to nonprofit organizations.⁷⁷ See *Sections F. Lobbying* and *Section G. Political Campaign Activities of Chapter One: General Overview of Federal Grant Law* and *Section D. Lobbying and Section E. Political Campaign Activities of Chapter Four: General Tax-Exempt Requirements*.

Memberships, Subscriptions, and Professional Activity Costs

Costs of a non-federal entity's membership in business, technical, and professional organizations are allowable. Also allowable are costs of subscriptions to business, professional, and technical periodicals as well as costs of membership in any civic or community organization with prior approval by the federal awarding agency or pass-through entity. Costs of membership in organizations whose primary purpose is lobbying are unallowable.⁷⁸

Proposal Costs

Proposal costs of the current accounting period of both successful and unsuccessful bids are allowable. Proposal costs include the cost of preparing bids, proposals, or applications on potential federal and non-federal awards or projects, including the development of data necessary to support the bids or proposals. Proposal costs are normally treated as indirect costs and allocated to all current activities of the entity. No proposal costs of past accounting periods are allocable to the current period.⁷⁹

Rearrangement and Reconversion Costs

Costs incurred for ordinary and normal rearrangement and alteration of facilities are allowable as indirect costs, whereas costs incurred for special arrangements and alterations are allowable as direct costs with prior approval from the federal awarding agency or pass-through entity.⁸⁰

Rental Costs of Real Property and Equipment

Rental costs are allowable to the extent that the rates are reasonable in light of factors such as rental costs of comparable property, if any; market conditions in the area; alternatives available; and the type, life expectancy, condition, and value of the property leased. The allowability of rental costs in the Uniform Guidance is subject to a number of limitations, including restrictions on “sale and lease back arrangements” and “less-than-arm’s-length” transactions.⁸¹

Travel Costs

Travel costs are allowable, subject to a number of restrictions, and must be incurred in accordance with an entity’s written travel reimbursement policy. To charge travel costs (including lodging, meals and incidentals) of employees and officers to a federal award, documentation must justify that: (i) participation of the individual is necessary to the federal award; and (ii) the costs are reasonable and consistent with the entity’s established travel policy.⁸²

I. Single Audit Requirements Under the Uniform Guidance

Any CAA that expends \$750,000 or more in federal awards during the CAA’s fiscal year must conduct a Single Audit in accordance with the provisions of the Uniform Guidance.⁸³ If a CAA expends less than \$750,000 in federal awards during its fiscal year, it is exempt from the Single Audit requirements; however, the CAA is required to make available, upon request, records for review or audit by the federal awarding agency, pass-through entity, or the Government Accountability Office (GAO).

With limited exceptions, Single Audits must be performed annually,⁸⁴ and a CAA may charge “a reasonably proportionate share” of costs involved with performing the audit to the federal award.⁸⁵

In addition to the Single Audit requirements, there are a number of CSBG Organizational Standards pertaining to audits. These Standards require a nonprofit CAA to: (i) have an annual audit completed by a Certified Public Accountant in accordance with the Uniform Guidance; (ii) address all findings from the previous year’s audit where appropriate; (iii) have the auditor present its audit to the board and the board formally receive and accept the audit; and (iv) solicit bids for its audit within the last five years. Similar requirements exist for public CAAs.⁸⁶ See *Section B. Overview of Laws and Guidance of Chapter Two: Community Services Block Grant* for more information on the CSBG Organizational Standards.

Scope of the Single Audit

The scope of a Single Audit is broad, combining the elements of traditional financial statement audits with the more comprehensive aspects of the [Yellow Book](#) (i.e. GAGAS) audits of federal money, as well as an analysis of internal controls and compliance with federal grant laws. The Single Audit is generally comprised of four parts. First, the auditor reviews the organization’s financial statements to determine whether they are presented fairly in all material respects in accordance with generally accepted accounting principles (GAAP).⁸⁷ For financial statements to be fairly presented does not mean that every number is perfectly correct. Rather, the financial statements must allow the reader to make accurate conclusions about the financial condition of the organization.⁸⁸ Another aspect of the financial statement review is that the auditor must determine

whether the schedule of federal award expenditures is fairly stated in all material respects in relation to the organization’s financial statements as a whole.⁸⁹

Second, the auditor evaluates the CAA’s system of internal controls to ensure that it meets the standards in OMB’s annual Compliance Supplement, available on OMB’s [website](#).⁹⁰ The supplement standards are based on the internal control integrated framework, created by COSO as discussed in greater detail above in *Section F. Financial Management Systems Under the Uniform Administrative Requirements*.⁹¹

Third, the auditor determines if the CAA complied with federal statutes, regulations, and the terms and conditions of federal awards that may directly and materially effect each of its major programs. The principal compliance requirements applicable to most federal programs, including CSBG, are included in the Compliance Supplement.⁹²

Areas an auditor evaluates for compliance:	
✓	Cost allocation plans;
✓	Federally negotiated indirect cost rates;
✓	Allocation of personnel costs;
✓	Allocation of other costs;
✓	Procurement policies;
✓	Cost sharing and matching fund methodologies;
✓	Management of property acquired with federal funds; and
✓	Governance, including compliance with CSBG-specific governance requirements.

Fourth, the auditor must follow up on prior audit findings, perform procedures to assess the reasonableness of the summary schedule of prior audit findings prepared by the CAA, and report, as a current year audit finding, when the auditor concludes that the summary schedule of prior audit findings materially misrepresents the status of any prior audit finding. The auditor performs audit follow-up procedures regardless of whether a prior audit finding relates to a major program in the current year.⁹³

CAA’s Role in a Single Audit

CAAs subject to a Single Audit have four primary responsibilities in the course of the audit. First, the CAA must retain the auditor using the appropriate procurement procedures, found in section 200.509 of the Uniform Guidance. These procedures include a requirement that CAAs follow the general procurement standards found in sections 200.317 through 200.326 of the Uniform Guidance. Additional factors to consider in evaluating each proposal for audit services include the bidder’s responsiveness to the request for proposal, relevant experience, availability of staff with professional qualifications and technical abilities, the results of

peer and external quality control reviews, and price. CAAs must also, whenever possible, make positive efforts to use small businesses, minority-owned firms, and women’s business enterprises.⁹⁴

The second main responsibility of the CAA is to prepare appropriate financial statements, including a schedule of federal award expenditures in accordance with section 200.510 of the Uniform Guidance.⁹⁵ It is a common misconception that auditors prepare financial statements; however, this is management’s responsibility. Auditors are prohibited by professional standards governing auditor independence from preparing the financial statements that they are then asked to audit.⁹⁶ During the course of an audit, the auditors may require adjustments to the financial statements because an accounting principle was incorrectly applied or because errors are uncovered, but by and large, this is (and should be) the extent of the auditor’s involvement in the preparation of the financial statements. The CAA must provide the auditor with access to personnel, accounts, books, records, supporting documentation, and other information as needed for the auditor to perform the required audit.⁹⁷

Third, the CAA must promptly follow up and take corrective action on audit findings, including preparing a summary schedule of prior audit findings and a corrective action plan in accordance with section 200.511 of the Uniform Guidance.⁹⁸ The corrective action plan must provide the name(s) of the contact persons(s) responsible for the corrective action, the corrective action planned, and the anticipated completion date. If the CAA does not agree with the audit findings or believes corrective action is not required, then the corrective action plan must include an explanation and specific reasons for the CAA’s conclusions.⁹⁹

Lastly, the CAA is tasked with proper submission of the audit report. CAAs must submit to the Federal Audit Clearinghouse a set of data and a package of reports, the contents of which are prescribed in section 200.512 of the Uniform Guidance and include financial statements, a schedule of expenditures of federal awards, a summary schedule of prior audit findings, the auditor’s reports, and corrective action plans, if any. A CAA must submit the data and reporting package within 30 calendar days after receipt of the auditor’s report or nine months after the end of the audit period, whichever is sooner. CAAs must also make copies of audit reports available for public inspection, although CAAs and their auditors should ensure the protection of personally identifiable information when doing so.

Nonprofit CAA Board’s Role in a Single Audit

The board of a nonprofit CAA plays a critical role in the process of a Single Audit. Commonly, the board exercises its duties with respect to the Single Audit through an audit committee. The function of the audit

The function of the audit committee is to act on behalf of the board in connection with the audit.

committee is to act on behalf of the board in connection with the audit. The audit committee must work closely with management, as both have a role in the process. The allocation of required tasks between management and the board depends in part on the depth of the audit committee’s knowledge and experience, the time its members are willing to commit to what is often an involved process, and the appropriateness of the division of responsibilities.

For example, the audit committee should review the management representations in the auditor engagement letter, but management must sign the letter, thus placing primary responsibility for this aspect of the audit on management.

One of the primary responsibilities of the board is to select the auditor. It should always be the board, not management, that is in charge of retaining the auditor. One of the purposes of an audit is to provide the board with comfort that management has produced financial statements that present the CAA’s financial results and position accurately in all material respects in accordance with GAAP. Although the Single Audit is

a requirement of the federal government, the board is one of the intended beneficiaries of the audit and thus the board should emphasize to both the auditor and management that it views the audit as an integral part of the board's oversight function. Taking charge of the selection process reinforces that message to all parties involved.¹⁰⁰

Boards must take into account the practical limitations of board involvement in a Single Audit. CAA boards are comprised of volunteers who often face time constraints due to families and jobs. Moreover, many volunteers will lack the financial background needed to make an informed auditor selection. For these reasons, management is often involved in the auditor selection process. It may assemble the list of candidates and conduct the initial interviews. This approach is acceptable if:

- Management prepares a report discussing the results of the selection process;
- The board or its audit committee discusses the report and management's recommendations with management;
- The board or its audit committee meets with the finalists to conduct an interview and listen to presentations; and
- The board makes the final decision and the engagement letter indicates that the auditor's duties run to the board.¹⁰¹

The board is responsible for overseeing other key aspects of the audit process, some of which are addressed below in greater detail.

PRACTICE TIPS

Other Board Audit Responsibilities

Assure Auditor Independence. In adhering to professional codes of conduct, the outside auditor should continuously evaluate its independence, particularly when the auditor also provides non-attest (e.g., consulting) services to the CAA. The audit committee should also assess the auditor's independence. The committee may decide to impose a higher standard for independence than required under applicable professional codes of conduct. For example, some audit committees may require that all non-attest services (e.g., consulting services) be pre-approved by the committee, particularly if the CAA's management will contract for and direct the non-attest services.¹⁰²

Communicate with the Auditor. The auditor is required to communicate to the board: (i) the auditor's responsibilities under Generally Accepted Accounting Standards (GAAS); (ii) an overview of the planned scope and timing of the audit; and (iii) significant findings from the audit. The auditing standards contemplate a formal communication process, specifying which communications are written or oral. Statement of Auditing Standards (SAS) No. 115 requires the auditor to communicate to the board significant control deficiencies and material weaknesses in the system of internal controls. The audit committee should have members capable of facilitating the committee's role in the discussions. These members must understand the implications of the communications and be in a position to demand that management respond appropriately.¹⁰³

Oversee the Integrity of Internal Controls. Management, not the audit committee, is charged with designing and implementing the CAA's system of internal controls. The audit committee, however, receives the results of the audit from the auditor and must address any issues raised by the audit. To address these issues, the committee should review the auditor's written communication regarding control deficiencies, engage in a discussion with management about the deficiencies and the need to make changes in systems, and require periodic progress reports from management. Auditors are required to start their auditing procedures the next year by examining whether previous deficiencies were resolved and how the board handled the audit findings.¹⁰⁴

A helpful resource for boards and audit committees on fulfilling their audit responsibilities is the American Institute of Certified Public Accountants' (AICPA) *Audit Committee Toolkit for Not For Profit Organizations*, which can be found on AICPA's [website](#).

Management's Role in a Single Audit

Despite the previous section's emphasis on board involvement, management has a clear role in the audit that does not involve the board's active participation—preparing the CAA and its financial statements for the audit.

Pre-Audit Planning

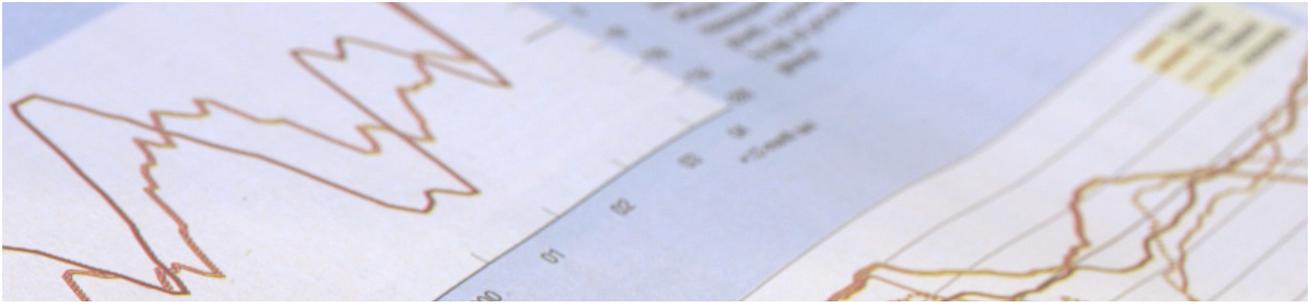
In planning for the audit, management should ask the auditor for a timeline covering all phases of management's work on the audit and work with the auditor to achieve any timeline revisions needed. Management should be cognizant of the different deadlines that various federal grant programs impose (such as the Head Start requirement to submit audits within four months of the end of the prior budget period, which differs from the Single Audit requirement to submit audits within 30 calendar days after receipt of the auditor's report or nine months after the end of the audit period, whichever is sooner).¹⁰⁵

In addition to planning around the timing of the audit process, management will also want to understand the auditor's preferences for electronic or paper-based versions of information and reach an agreement with the auditor regarding the format in which to deliver the documents. Management should also understand the auditor's preferred format for the variety of schedules and reconciliations that management is tasked with preparing. It may also be helpful for management to review the prior year's management representation letter and then ask the auditor to identify any items that are likely to be added to the current year's management representation letter. Note, however, that this preliminary planning conversation is not conclusive, as the auditor may identify additional issues and concerns during the course of the audit.¹⁰⁶

Financial Statement Preparation

The financial statements reflect management's presentation of financial activity, results, and position and also serve as management's assertion that it has complied with applicable laws, regulations, and contractual requirements.

Given the requirements for obtaining an unqualified audit opinion, most CAAs prepare their year-end financial statements in a format which complies with GAAP. This format includes notes to the financial statements providing all GAAP-required disclosures, as well as the statement of financial position (balance sheet),



statement of activities (income statement), statement of cash flows, and statement of functional expenses. This may require the year-end statements to be prepared in formats which differ from those used for monthly reporting to the board or other purposes during the fiscal year.

The prior year's audited financial statements are the starting point for preparation of the current year's financial statements, but management must consider whether changes in GAAP requirements and/or changes in the nature of the CAA's activities, transactions, or other factors require additional disclosures or possible changes in format.

Some CAAs choose to work with a qualified outside accounting consultant to assist with the preparation of the year-end financial statements to ensure they are complete and comply with GAAP requirements. However, the CAA must retain responsibility for the accuracy and completeness of the financial statements even when they are prepared with outside assistance.¹⁰⁷

Internal Controls

Management is responsible for ensuring the development and implementation of effective approaches to enterprise risk management, including the analyses, systems, policies, and procedures necessary to identify and control the risks inherent in operating a legal entity serving the public, employing staff, and entering into contracts. The auditor is required to understand the CAA's business, the risks inherent in its operations, and the controls it puts in place to mitigate those risks. For a more detailed discussion of internal controls, please see *Section F. Financial Management Systems Under the Uniform Administrative Requirements* above.

Conclusion

Preparing for an audit is an involved process. To efficiently provide the auditor with what he/she needs, management should place a premium on thorough pre-audit planning and meetings with the auditor. From a longer-term perspective, management should focus on putting in place a solid system of internal controls, together with effective record retention policies. A CAA with poor systems will struggle as it attempts to meet the demands that the auditor places on it. CAAs that place a premium on good systems will experience far less trouble preparing for the audit. Those systems will reduce the burden on both the CAA and its auditor.

J. Nonprofit CAA Financial Statements

Overview

Financial statements report the CAA's operating results and its financial condition. Over time, a body of rules and conventions have developed for financial statement presentation. This body of rules is referred to as generally accepted accounting principles (GAAP). If an organization that does not follow GAAP undergoes an

audit, the auditor's opinion letter most often will include a qualification that the statements do not conform to GAAP. For CAAs that undergo a Single Audit, the auditor is required to determine and note whether the financial statements comply with GAAP. Some funding sources may not accept an audit report with a non-GAAP qualification. CSBG Organizational Standard 8.1 for nonprofit CAAs requires that a Certified Public Accountant complete the organization's annual audit or audited financial statements in accordance with the Uniform Guidance and/or state audit threshold requirements.¹⁰⁸

Board Review of Financial Statements

Every regular board meeting should include a review of the CAA's financial statements, whether they are year-end audited statements or interim statements. Typically the interim statements are less formal than the audited ones.

PRACTICE TIPS

A Five Step Approach to Periodic Review of a CAA's Financial Health

Preliminary review by the finance committee of a CAA's financial statements in advance of the board meeting and reporting on the financial statements at the meeting.

Review by every board member of financial information he or she receives in advance of the scheduled board meeting, which should include a complete set of financial statements and, if possible, an analysis of the financial statements.

Regular, thorough discussion of the financial statements ensuring that sufficient time is set aside to do so in the board meeting agenda.

Once-a-year discussions for the full board to address in detail the auditor's annual report and management letter; annual organization-wide budget; system of internal controls; overall financial health, including liquidity and unrestricted net assets; and long-term financial plans and needs.

Question and answer time set aside as a part of each discussion of the CAA's finances.

Types and Uses of Nonprofit Financial Statements

Financial statements are the traditional tool used to analyze an organization's finances. Most nonprofit boards review the annual financial statements prepared by management at the end of the fiscal year in preparation for the annual independent audit. Management also should prepare interim financial statements each month as a tool to monitor the CAA's financial health. These are usually prepared and reviewed by the finance committee on a monthly basis. The full board should review the interim financial statements at its regular meetings throughout the year. These statements might not contain final adjustments for items like the allowances for depreciation that are included in the audited financial statements, but they can and should accurately reflect revenues, major expenses, and asset and liability balances.

Financial statements for nonprofit CAAs are usually comprised of the following four basic statements, plus footnotes:

The Statement of Financial Position

More commonly known as the “balance sheet”, the statement of financial position reports a CAA’s financial condition as of a given date. It includes assets, liabilities, and net assets—what the CAA owns, what it owes to creditors, and its net worth.

The Income Statement

The income statement reports the CAA’s income and expenses for a specified period of time. It is often referred to as the “profit and loss statement” or the “statement of activities”. The income statement and the budget are two distinct documents. The income statement reports what has happened in the past, while the budget is a plan or projection of future events. While the audited financial statements include an income statement for the entire fiscal year, every CAA also needs to prepare interim income statements that report income and expenses for the current month and the fiscal year to date. The income statement explains what happened during a specified period. It connects the prior year’s (or period’s) ending balance sheet with the current accounting period and explains the changes in the CAA’s net assets and liabilities.

The Statement of Cash Flow

The statement of cash flow is the most complex of the four financial statements. The rules that govern financial accounting place heavy emphasis on measuring economic income rather than cash inflows and outflows. However, accounting income itself may not present a complete picture of a CAA’s financial health. Both management and the board must focus on cash inflows and outflows—referred to as “cash flow.” The statement of cash flow converts accounting conventions and concepts to make it clear how the organization obtained and used cash.

The Statement of Functional Expenses

The statement of functional expenses divides the CAA’s expenses into at least three categories: program services, fundraising, and management and general expenses. The accounting rules specifically require nonprofits providing human services (organizations classified as “voluntary health and welfare” organizations) to provide a more detailed breakdown of their expenses in either a statement of functional expenses or a footnote to the financial statements. The statement of functional expenses uses a matrix format to show specific line item expenses incurred for programs, fundraising, and management functions. For interim financial statements reviewed by the board and management, many CAAs go beyond the GAAP requirement to break down expenses by function (program, fundraising, and management) to also present the income associated with each of these functions.

Footnotes to the Financial Statements

The annual financial statements contain footnotes that provide background information about the CAA and details about how various accounting conventions were applied in assembling the statements. These are considered an integral part of the financial statements. When asked to review financial statements, most financial professionals will start with the footnotes. While CAAs will prepare footnotes to their annual financial statements, many will not prepare complete footnotes to monthly interim financial statements.

For more information on financial statements, see CAPLAW’s [Tools for Top-Notch CAAs](#); the national Community Action Partnership’s [Fiscal Fundamentals for Executive Directors](#); and the national Community Action Partnership’s [Audit Essentials: What Every Board Member Needs to Know](#).

K. Annual Budget

Even though the Uniform Guidance does not require non-federal entities to create annual budgets, some federal funding sources do. For example, CSBG Organizational Standard 8.4 requires, for nonprofit CAAs, that the board “annually approves an organization-wide budget” and, for public CAAs, that the “tripartite board/ advisory body has input as allowed by local governmental procedure into the CSBG budget process.”

The annual operating budget is a comprehensive financial plan that projects all income and all expenses that a CAA expects to receive or incur within its fiscal year. The annual budget fulfills two key functions: planning and authorization. As a planning tool initiated by management, the budget functions as a comprehensive plan to obtain and use resources to fulfill the CAA’s mission and meet all contractual and legal obligations. Board approval of the annual operating budget authorizes management to proceed with implementing the plan. Board approval also provides evidence that board members are fulfilling their responsibilities to direct the use of resources to fulfill the CAA’s mission and ensure compliance with legal obligations. In addition to the key planning and authorization functions, the annual operating budget functions as an important internal control when it is used as a point of comparison with actual financial results achieved, facilitating identification of errors or irregularities and needed corrections. *Section 3. Creating the Annual Operating Budget* of CAPLAW’s [Tools for Top-Notch CAAs](#) walks through how a CAA creates an annual budget and the roles that the board and the CAA’s executive management each play in doing so.

Notes

- ¹ 2 C.F.R. § 200.110(a)
² COFAR FAQ 200.110-12
³ 78 Federal Register (Fed. Reg.) 78590 (Dec. 26, 2013); 2 C.F.R. Part 200
⁴ 2 C.F.R. § 200.101(b)(1)
⁵ 2 C.F.R. § 200.101(e)
⁶ 2 C.F.R. § 200.101(d)
⁷ See 42 U.S.C. § 9916(a)(1)(B)
⁸ 2 C.F.R. § 200.202
⁹ 2 C.F.R. § 200.203
¹⁰ 2 C.F.R. § 200.205
¹¹ 2 C.F.R. § 200.207
¹² 2 C.F.R. § 200.210
¹³ 2 C.F.R. § 200.211
¹⁴ 2 C.F.R. § 200.301
¹⁵ 2 C.F.R. § 200.302
¹⁶ 2 C.F.R. § 200.303
¹⁷ 2 C.F.R. § 200.305
¹⁸ 2 C.F.R. § 200.306
¹⁹ 2 C.F.R. § 200.314
²⁰ 2 C.F.R. § 200.318
²¹ 2 C.F.R. § 200.320
²² 2 C.F.R. § 200.321
²³ 2 C.F.R. § 200.323
²⁴ 2 C.F.R. § 200.324
²⁵ COFAR FAQ 200.31-6 and 200.331-7
²⁶ 2 C.F.R. § 200.302
²⁷ 2 C.F.R. § 200.303
²⁸ National Community Action Partnership's Audit Essentials, 30
²⁹ U.S. Government and Accountability Office Green Book, 21 (2014)
³⁰ U.S. Government and Accountability Office Green Book, 34 (2014)
³¹ U.S. Government and Accountability Office Green Book, 44 (2014)
³² U.S. Government and Accountability Office Green Book, 58
³³ U.S. Government and Accountability Office Green Book, 64
³⁴ COFAR FAQ .110-6
³⁵ 2 C.F.R. § 200.319
³⁶ 2 C.F.R. § 200.318
³⁷ 2 C.F.R. § 200.321
³⁸ 2 C.F.R. § 200.320
³⁹ 48 C.F.R. § 2.101
⁴⁰ 2 C.F.R. § 200.318(i)
⁴¹ 2 C.F.R. § 200.306(b)
⁴² 2 C.F.R. § 200.306(b)(5)
⁴³ Office of Community Services (OCS) Information Memorandum (IM) 135; OCS IM 139
⁴⁴ 2 C.F.R. § 200.306(c)
⁴⁵ 2 C.F.R. § 200.434(c)
⁴⁶ 2 C.F.R. § 200.80, 200.307(d), (e)
⁴⁷ 2 C.F.R. § 200.307(e)
⁴⁸ 2 C.F.R. § 200.307(b)
⁴⁹ 2 C.F.R. § 200.307(f)
⁵⁰ 2 C.F.R. § 200.403
⁵¹ 2 C.F.R. § 200.404
⁵² 2 C.F.R. § 200.413
⁵³ 2 C.F.R. § 200.56
⁵⁴ 2 C.F.R. § 200.413(c)
⁵⁵ 2 C.F.R. § 200.405(c)
⁵⁶ 2 C.F.R. § 200.405(d)
⁵⁷ COFAR FAQ .331-6
⁵⁸ Appendix IV to Part 200, C.2.a
⁵⁹ 78 Fed. Reg. 78590, 78590-78591
⁶⁰ 2 C.F.R. § 200.101(b)(1)
⁶¹ 2 C.F.R. § 200.101(e)
⁶² 2 C.F.R. § 200.405(d)
⁶³ 2 C.F.R. § 200.420
⁶⁴ 2 C.F.R. § 200.421
⁶⁵ 2 C.F.R. § 200.425
⁶⁶ COFAR FAQ 200.110-12 (updated from previous Q II-1) (Aug. 29, 2014)
⁶⁷ 2 C.F.R. § 200.430(i)
⁶⁸ 2 C.F.R. § 200.430
⁶⁹ 2 C.F.R. § 200.430(i)(8)
⁷⁰ 2 C.F.R. § 200.431
⁷¹ 2 C.F.R. § 200.437
⁷² 2 C.F.R. § 200.438
⁷³ 2 C.F.R. § 200.441
⁷⁴ 2 C.F.R. § 200.442
⁷⁵ 2 C.F.R. § 200.447
⁷⁶ 2 C.F.R. § 200.449
⁷⁷ 2 C.F.R. § 200.450
⁷⁸ 2 C.F.R. § 200.454
⁷⁹ 2 C.F.R. § 200.460
⁸⁰ 2 C.F.R. § 200.462
⁸¹ 2 C.F.R. § 200.465
⁸² 2 C.F.R. § 200.474
⁸³ 2 C.F.R. § 200.501
⁸⁴ 2 C.F.R. § 200.504
⁸⁵ 2 C.F.R. § 200.425
⁸⁶ OCS IM 138
⁸⁷ 2 C.F.R. § 200.514(b)
⁸⁸ Community Action Partnership's Audit Essentials toolkit
⁸⁹ 2 C.F.R. § 200.514(b)
⁹⁰ 2 C.F.R. § 200.514(c)
⁹¹ 2 C.F.R. § 200.514(c)(1)
⁹² 2 C.F.R. § 200.514(d)
⁹³ 2 C.F.R. § 200.514(e)
⁹⁴ 2 C.F.R. § 200.508
⁹⁵ 2 C.F.R. § 200.508
⁹⁶ See AICPA Code of Professional Conduct, Sections 1.295.105, 130, 135, and the U.S. Government and Accountability Office Yellow Book, Sections 3.40 and 3.46
⁹⁷ 2 C.F.R. § 200.508(d)
⁹⁸ 2 C.F.R. § 200.508(c)
⁹⁹ 2 C.F.R. § 200.511(c)
¹⁰⁰ Tools for Top-Notch CAAs, 47
¹⁰¹ Tools for Top-Notch CAAs, 47
¹⁰² Tools for Top-Notch CAAs, 56
¹⁰³ Tools for Top-Notch CAAs, 56
¹⁰⁴ Tools for Top-Notch CAAs, 56
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¹⁰⁸ OCS IM 138

Chapter Four: General Tax-Exempt Organization Requirements

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Chapter Four

General Tax-Exempt Organization Requirements

A. Introduction

This chapter discusses the key requirements that apply to CAAs operating as 501(c)(3) tax-exempt organizations under federal tax law. Thus, this chapter will not be applicable for CAAs that are divisions or departments of local governments. While many of the rules described here apply to all tax-exempt organizations, for certain issues such as lobbying and political activity, federal grant laws create an additional layer of requirements to which private CAAs must pay close attention. Thus, nonprofit CAAs are advised to read the tax-exempt organization rules in this chapter alongside the federal grant law requirements described in *Chapter One: General Overview of Federal Grant Law*.

Nonprofit CAAs typically operate as 501(c)(3) organizations that are exempt from federal income tax on income related to their exempt purpose. Contributions made to 501(c)(3) organizations are deductible on the donor's federal income tax return if the donor chooses to itemize deductions. Other exemptions that 501(c)(3) organizations may be eligible for include certain employment, state income, sales, and property taxes.

It is important to recognize that not all nonprofit organizations are tax-exempt under federal law. The Internal Revenue Service (IRS) recognizes several types of organizations that qualify for federal income tax exemption under section 501(c) of the Internal Revenue Code (Code).¹ Nonprofit CAAs generally qualify as "charitable organizations" under section 501(c)(3) of the Code. Other common types of exempt organizations under the Code include:

- 501(c)(2) Title-Holding Corporations for a Single Exempt Parent Organization
- 501(c)(4) Civic Leagues, Social Welfare Organizations
- 501(c)(5) Labor, Agricultural, or Horticultural Organizations
- 501(c)(6) Business Leagues, Chambers of Commerce
- 501(c)(7) Social and Recreational Clubs
- 501(c)(8) Fraternal Beneficiary Societies and Associations
- 501(c)(10) Domestic Fraternal Societies and Associations
- 501(c)(19) Veterans' Organizations
- 501(c)(25) Title-Holding Corporations for Multiple Exempt Parent Organizations

To qualify for exemption under section 501(c)(3) of the Code, an organization must be organized and operated exclusively for one or more exempt purposes. Permissible exempt purposes in section 501(c)(3) of the

Code are charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international sports competition, and preventing cruelty to children or animals.

A charitable organization organized for one of these exempt purposes generally must file a Form 1023 (or a Form 1023-EZ, if eligible) with the IRS to be recognized as tax-exempt. If the IRS approves the application, it will issue a “determination letter” indicating the section of the Code under which the organization is exempt from federal income tax. In its application on Forms 1023 or 1023-EZ, the entity must show that it is organized as a nonprofit corporation, trust, or unincorporated association under state law. In addition, the entity’s organizing documents (e.g., articles of incorporation, trust documents, articles of association, etc.) must limit its purposes to those described in section 501(c)(3) of the Code, restrict its authority to engage in activities that do not further those purposes, and dedicate its assets only to exempt purposes.

Activities a 501(c)(3) cannot engage in include:	
X	Performing lobbying activities as a substantial part of its overall activities or participating in political campaigns on behalf of, or in opposition to, any candidate for public office (see <i>Section D. Lobbying and Section E. Political Activities</i> in this Chapter);
X	Allowing its earnings to inure to the benefit of any private shareholder or individual (see <i>Section E. Private Benefit and Inurement</i> in this Chapter);
X	Operating for the benefit of private interests such as those of certain insiders (see <i>Section E. Private Benefit and Inurement</i> in this Chapter);
X	Operating for the primary purpose of conducting a trade or business that is not related to its exempt purpose (see <i>Section B. Unrelated Business Income Tax</i> in this Chapter); or
X	Performing activities that are illegal or that violate fundamental public policy.

This chapter will address a number of issues that nonprofit CAAs with 501(c)(3) exempt status (also referred to as nonprofit CAAs) commonly face and discuss the activities that such CAAs should avoid or limit to protect their 501(c)(3) exempt status.

B. Unrelated Business Income Tax

While nonprofit CAAs are generally exempt from federal income tax, they may incur taxes on income from certain activities that are not related to their exempt purposes. Specifically, CAAs that generate income from an unrelated trade or business may be liable for the federal unrelated business income tax (UBIT) on the net income generated from the trade or business.² To ensure that tax-exempt organizations do not have an unfair competitive advantage over for-profit entities, Congress added the UBIT rules to force tax-exempt organizations to pay their fair share of taxes when engaged in commercial activity outside the scope of their exempt purposes.



What Counts as Unrelated Business Income?

Nonprofit organizations are subject to UBIT on income from business activities that (i) constitute a trade or a business, (ii) are regularly carried on and (iii) are not substantially related to the furtherance of the organization's tax-exempt purposes.³ An activity must satisfy each of the three parts of the test for generated income to be subject to UBIT.

Trade or Business

The term "trade or business" generally includes any activity that generates income from selling goods or performing services. In its analysis, the IRS will consider a number of factors, including: whether the organization conducts the activity with the intent to profit; whether the activity competes unfairly with for-profit, commercial enterprises providing the same services but whose earnings are taxable; whether the nonprofit organization operates the activity in a competitive, commercial manner similar to a for-profit enterprise; and whether the nonprofit organization devotes extensive and active time, energy, and other resources toward the activity. An activity may be deemed a trade or business even if it is conducted within a larger group of similar activities that are related to the organization's exempt purpose and even if the activity operates at a loss to the organization. For example, soliciting, selling, and publishing commercial advertising is considered a trade or business even though the organization publishes the advertisements in its regular newsletter that has content related to its exempt purposes, and even if the income generated from the advertisements does not always offset direct and indirect costs.⁴

Regularly Carried On

An activity is considered "regularly carried on" if an organization engages in it frequently or continuously and pursues it in a manner similar to comparable commercial activities. Activities that are carried on for only a limited duration or on an infrequent basis, on the other hand, are unlikely to be considered "regularly carried on." An activity that an organization conducts once each year is also generally not considered "regularly carried on."⁵ For example, income generated from an annual charity fundraising event would not be income from a regularly carried on trade or business.⁶ Further, operating a food stand for two weeks at a state fair once a year would not constitute regular conduct, since the stand would not compete with a comparable operation that a for-profit entity might run year-round. However, operating a commercial parking lot every Saturday, year-round, would be the regular conduct of a trade or business.⁷

Not Substantially Related to the Organization's Exempt Purposes

An activity is considered "substantially related" to the organization's exempt purpose if it contributes importantly to accomplishing that purpose. The fact that an organization needs or uses the funds generated by the activity to support other activities related to the organization's exempt purpose is not enough to make

the activity substantially related. Whether a trade or business is substantially related to an organization’s exempt purpose depends on the facts and circumstances of each case, and the IRS will consider the following factors:

Factors considered in determining exempt purpose:	
✓	The size and extent of the activity in relation to the nature and extent of the exempt function that the organization purports to serve;
✓	The comparability of fees charged to the general public to those charged at commercial facilities;
✓	Whether only those who purchase the goods or services benefit from the activity, and whether the benefits are in direct proportion to the fees charged;
✓	Whether the organization furnishes and operates the facilities through its own employees and whether such employees perform substantial services in providing the activity; and
✓	Whether revenue maximization is a predominant element in the organization’s conduct of the activity.

If the IRS finds certain portions of the activity to be substantially related to the organization’s exempt purposes and other portions **not** to be substantially related, it will divide the activity into related and unrelated pieces. Thus, in the example above, income from the youth health and wellness membership dues would not be subject to UBIT, while income from the general public gym membership fees would be subject to UBIT.

What Doesn’t Count as Unrelated Business Income?

Certain activities are specifically excluded from the definition of “unrelated trade or business” even if they satisfy all three requirements of the test described above. A few of the excluded activities are listed in the following table, and additional examples can be found in [IRS Publication 598](#).

Excluded Activities	Description
Sale of donated merchandise	The sale of merchandise, substantially all of which the organization received as gifts or contributions, is not subject to UBIT. ¹⁰ For example, a thrift shop operated by a tax-exempt organization that sells donated clothes and books to the general public, with the proceeds going to the exempt organization, would not be subject to UBIT.
Sale of products created from tax-exempt activities	An organization that sells products made in the course of performing the organization’s exempt functions (e.g., a disability rehabilitation center selling items made by individuals with disabilities as part of their rehabilitation training) is not subject to UBIT, so long as the product is sold in substantially the same state in which it was produced. ¹¹

Excluded Activities	Description
Activities conducted by the organization's volunteers	Any trade or business in which substantially all of the work is performed for the organization without compensation is not an unrelated trade or business. ⁸ Thus, income generated by a retail store where volunteers perform substantially all of the work would not be subject to UBIT.
Activities conducted for the convenience of employees or clients	A trade or business conducted by a tax-exempt entity primarily for the convenience of its members, students, patients, officers, or employees is not an unrelated trade or business. ⁹ For example, if an organization operates vending machines for use by its employees or clients who receive services at its facility, the net income generated from the vending machines will not be subject to UBIT.
Convention and trade show activity	Qualified convention or trade show activities conducted at a convention, annual meeting, or trade show are not treated as an unrelated trade or business. ¹² Consequently, income from qualified convention and trade show activities, derived by a qualifying organization that sponsors the qualified convention or trade show, will not be subject to UBIT. ¹³ A qualified convention or trade show activity is any activity typically conducted at a convention, annual meeting, or show if: (i) one of the purposes of the organization in sponsoring the activity is promoting and stimulating interest in, and demand for, the products and services of that industry or educating those in attendance regarding new products and services or new rules and regulations affecting the industry; and (ii) the show is designed to achieve its purpose through the character of the exhibits and the industry products that are displayed.
Rental income from real property	Generally, rental income from real property or incidental personal property will not be subject to UBIT. However, if the organization provides personal services in connection with the rental, or if the rental income comes from debt-financed property, the rental income will be subject to UBIT. ¹⁵ If substantially all of the debt-financed property is used in a way that is substantially related to the organization's tax-exempt purposes, the property is not treated as debt-financed property and all of the rental income from the property will be treated as exempt from UBIT. ¹⁶ In general, this applies if 85% or more of the use of such property is devoted to the organization's exempt purpose. The extent to which property is used for a particular purpose depends on all the facts and circumstances. The IRS may compare (i) the portion of time property is used for exempt purposes with the total time it is used for any purpose, or (ii) the portion of property that is used for exempt purposes with the portion used for all purposes. ¹⁷ For example, if an organization regularly operates a parking lot for the general public's use (as opposed to use by employees or clients) and charges a parking fee, the income generated from the parking fees would be subject to UBIT, even if the organization acquired the parking lot without debt financing, because of the personal services involved in operating a parking lot. However, income generated from an organization's regular rentals of its facilities to for-profit tenants would not be subject to UBIT if the building's mortgage has been paid in full and the organization does not provide any services (such as a receptionist) in connection with the rental.

Excluded Activities	Description
<p>“Passive” investment income</p>	<p>Dividends, interest, royalties, rents, and annuity payments are excluded from calculating income subject to UBIT. However, to the extent that a nonprofit’s “controlled”¹⁴ taxable subsidiary receives a tax benefit from deducting interest, royalties, rents, or annuities paid to the nonprofit parent (i.e., to the extent the deduction reduces the net unrelated income of the controlled subsidiary), such payments will be subject to UBIT. Only the amount in excess of a “fair market value” standard is subject to UBIT; thus, so long as the controlled subsidiary makes passive income payments at fair market value to the controlling parent, the payments will not generate any taxable income to the parent. Note that all dividend income received by the nonprofit parent organization from the controlled subsidiary counts as “passive” investment income and will not be subject to UBIT.</p>
<p>Qualified sponsorship payments</p>	<p>Qualified sponsorship payments (QSP) are excluded from UBIT so long as they do not constitute advertising. Advertising income earned by a nonprofit organization, on the other hand, is taxable as unrelated business income. Advertising is material that is transmitted and which promotes or markets a business or service by using messages containing qualitative language, price information, or other indications of value, or an inducement to purchase.¹⁸ In contrast, a QSP is a payment made by a trade or business to a nonprofit organization for which there is no arrangement or expectation of any substantial return benefit, other than the use or acknowledgment of the name, logo, or product lines of such trade or business (IRS regulations provide specific information about what constitutes a “substantial return benefit”).¹⁹ QSPs are exempt from UBIT, regardless of whether the sponsored activity is related to the nonprofit organization’s exempt purpose.²⁰ The nonprofit organization may use or include the sponsor’s name or logo and include information such as the sponsor’s location, telephone number, internet address, slogans, and other value-neutral descriptions of the sponsor’s goods or services in acknowledging the sponsor’s support.²¹ For example, a message in an organization’s annual conference booklet by a conference sponsor that said, “Neighborhood Bank — stop by for a free consultation on our product offerings” would likely be considered advertising and thus generate UBIT for the sponsorship payment. On the other hand, a message that said, “Neighborhood Bank, a sponsor of this year’s conference, welcomes you to our city” would likely be a QSP because it merely acknowledges the sponsor and does not promote any of the sponsor’s products or services, and thus would not generate UBIT even if the organization includes the bank’s logo and contact information.</p>

Unrelated Business Income Tax Rate and Filing Requirements

The tax rate for UBIT is equal to the prevailing rate that applies to the legal form of entity (e.g., corporation, trust, etc.) and applies to any unrelated business income generated by a tax-exempt organization, less any allowable deductions which are directly connected to the carrying on of the trade or business. This tax is reduced by any applicable tax credits, including the general business credits. Organizations with gross unrelated business income of \$1,000 or more must file a Form 990-T and attach any required supporting

schedules and forms. Form 990-T is due by the 15th day of the 5th month after the end of the organization's tax year (e.g., for calendar year-end organizations, by May 15th). If the due date falls on a Saturday, Sunday, or legal holiday, the filing is due on the next business day. Organizations may request an automatic three-month extension of time to file using Form 8868, Application for Extension of Time to File an Exempt Organization Returns and an additional three-month extension upon showing reasonable cause for the additional time requested. For filings for fiscal year 2016 and beyond, organizations may request an automatic six-month extension. Certain states also impose a tax on unrelated business income and may require additional tax filings.

C. Charitable Contributions

Nonprofit CAAs are eligible to receive tax-deductible contributions from individual or business donors. The IRS imposes recordkeeping and substantiation rules on donors who make such contributions as well as disclosure rules on CAAs that receive certain *quid pro quo* contributions or vehicle donations.

Recordkeeping Rules

A donor may not claim a deduction for any monetary charitable contribution unless the donor has a bank record, such as a canceled check, or a written communication from the CAA, such as a receipt or letter.²² The record or written communication must show the name of the CAA and the date and amount of the contribution.²³ Donors who claim charitable contributions made by payroll deduction can satisfy the recordkeeping requirement by keeping a pay stub, W-2, or other document furnished by the employer that states the amount withheld for payment to the CAA, as well as a pledge card or other document prepared by the CAA that shows the donor's name.

Contemporaneous Written Acknowledgment

For any single contribution of \$250 or more, a donor must obtain a contemporaneous written acknowledgment from the CAA before the donor may claim a deduction for the charitable contribution on the donor's federal income tax return.²⁴ Although it is a donor's responsibility to obtain a written acknowledgment and an organization that does not acknowledge a contribution incurs no penalty, CAAs can assist a donor by providing a timely, written statement.

PRACTICE TIPS

Written statements should contain:

- Name** of the CAA;
- Amount** of cash contribution;
- Description** (but not the value) of non-cash contribution;
- Statement** that no goods or services were provided by the CAA in return for the contribution (if applicable); and
- Description and good faith estimate** of the value of goods or services, if any, that an organization provided in return for the contribution.

The CAA may provide a separate acknowledgment for each single contribution of \$250 or more, or use one acknowledgment, such as an annual summary, to cover several contributions of \$250 or more. The IRS does not prescribe a format for the written acknowledgment, and the CAA can provide either a paper copy or an electronic record via e-mail. A donor should not attach the written acknowledgment to his or her individual income tax return, but rather retain the record to substantiate the contribution.

Contemporaneous

To meet the contemporaneous requirement, a donor must receive the written acknowledgment by the earlier of: (i) the date on which the donor actually files his or her individual federal income tax return for the year of the contribution; or (ii) the due date (including extensions) of the return. CAAs typically send written acknowledgments to donors no later than January 31 of the year following the contribution.

Token Exception for Insubstantial Goods and Services

If a CAA provides goods and services in exchange for the donor's contribution, it must provide a good faith estimate of the value of such goods and services, as the donor must reduce the amount of the contribution deduction by the fair market value of the goods and services provided by the CAA. However, under the "token exception," an acknowledgment does not need to account for "insubstantial goods and services."²⁵ For goods and services provided by a CAA to fall within the token exception, either one of the following conditions must be true:

- The fair market value of the good or service received does not exceed the lesser of two percent of the donor's payment or \$106* OR
- The donor's payment is at least \$53.00* and the only items provided bear the CAA's name or logo and do not exceed \$10.60*, in the aggregate, for all items received by the donor during that year.

For example, if a CAA gives a coffee mug bearing its logo and costing no more than \$10.60 to a donor who contributes \$53.00, the CAA may state in its written acknowledgment that no goods or services were provided in return for the \$53.00 contribution, and the \$53.00 or more contribution is fully deductible.

Unreimbursed Expenses

A donor may also make a charitable contribution in the form of an unreimbursed expense. For example, an attorney may present a governance training for the CAA's board and may incur out-of-pocket transportation and lodging expenses in connection with the training that the CAA does not reimburse. In order to claim a deduction for these expenses, the donor must obtain a written acknowledgment from the CAA containing (i) a description of the services provided by the donor, (ii) a statement of whether or not the CAA provided goods or services in return for the contribution, and (iii) a description and good faith estimate of the value of



* Dollar amounts are for calendar year 2016. Amounts are adjusted annually for inflation.

goods or services, if any, that an organization provided in return for the contribution.²⁶ Note, however, that no deduction is available for the donation of the attorney's services (i.e., the value of the attorney's time in providing the governance training).

Quid Pro Quo Contributions

Since a donor may only take a contribution deduction to the extent that the contribution exceeds the fair market value of any goods or services received in return for the contribution, 501(c)(3) organizations are required to provide a written statement informing the donor of the value of the goods and services provided to the donor. A CAA must provide this written statement to any donor who makes a payment exceeding \$75, in part as a contribution and in part for goods and services (known as a *quid pro quo* contribution). The written statement must (i) inform the donor that the amount of the payment that is deductible for federal income tax purposes is limited to the excess of money (and the fair market value of property) contributed by the donor over the value of the goods and services provided by the CAA and (ii) provide the donor with a good-faith estimate of the fair market value of the goods and services provided by the CAA. The written statement must be clear and should not be in small print within a larger document.

Written statements are not required for goods and services that fall within the token exception described above. A CAA that fails to provide written statements for *quid pro quo* contributions is subject to a penalty of \$10 per contribution, not to exceed \$5,000 per fundraising event.

Written Acknowledgments and Statements

When providing written acknowledgments or statements to a donor, if the CAA provides any goods or services in return for the contribution, the CAA must indicate its good faith estimate of the fair market value of those goods or services, rather than the cost to the CAA of the goods or services. For example, if the CAA conducts a silent auction at its annual fundraising event and a donor bids \$500 on and wins a vacation package worth \$1000, the CAA must state that it provided goods or services to the donor with an estimated fair market value of \$1000, even if someone donated the package to the CAA (i.e., it did not cost the CAA anything to provide the good or service). Because the donor's bid (\$500) does not exceed the fair market value of the vacation package, the donor cannot take a charitable deduction for the \$500 contribution.

Examples:

Written Acknowledgments and Statements

"Thank you for your cash contribution of \$300 that [CAA's name] received on December 12, 2015. No goods or services were provided in exchange for your contribution."

"Thank you for your cash contribution of \$350 that [CAA's name] received on May 6, 2015. In exchange for your contribution, we gave you a booklet of movie tickets with an estimated fair market value of \$60."

"Thank you for your contribution of three office desks and five desk chairs that [CAA's name] received on March 15, 2016. No goods or services were provided in exchange for your contribution."

Donations of Qualified Vehicles

Donors may take a charitable deduction for donating certain qualified vehicles, including motor vehicles and boats. CAAs must provide a contemporaneous written acknowledgment of the donation to the donor and may do so using Form 1098-C or a separate written acknowledgment. The written acknowledgment must include (i) the donor's name and taxpayer identification number, (ii) the vehicle identification number, and (iii) the date of the contribution. If the CAA subsequently sells the vehicle with or without any significant intervening use or material improvement, the acknowledgment must also include additional information regarding the sale. Additional guidance on the information required in the written acknowledgment as well as deadlines for furnishing such acknowledgment to the donor are set forth in Section 3.03 of [IRS Notice 2005-44](#) and in [IRS Bulletin 2005-17](#).

CAAs must also report to the IRS via Copy A of Form 1098-C the information contained in the contemporaneous written acknowledgment provided to the donor of a qualified vehicle. The report is due by February 28 (March 31 if filing electronically) of the year following the year in which the CAA provides the written acknowledgment to the donor.

D. Lobbying

The IRS regulations governing 501(c)(3) tax exempt organization set forth restrictions that govern a nonprofit CAA's ability to lobby. Moreover, because nonprofit CAAs receive federal funding, they are subject to various, additional restrictions under (i) some authorizing statutes for federal awards, (ii) the federal appropriations acts funding their federal awards, (iii) the Office of Management and Budget (OMB) federal cost principles, and (iv) the federal award terms and conditions.

Generally speaking, a nonprofit CAA engages in **lobbying** if it attempts to influence the introduction, enactment, or modification of legislation, referenda, or other ballot initiatives. In some cases, the term "lobbying" may also be more broadly defined to include, for example, actions taken to support or defeat any proposed or pending regulation, administrative agency actions, or Executive Orders.²⁷

The main takeaway for a nonprofit CAA with respect to lobbying is that, as a 501(c)(3) tax-exempt organization, a nonprofit CAA may engage in a limited amount of lobbying under IRS rules and when doing so, must use unrestricted (non-federal) funds unless a specific (narrow) exception exists under the applicable federal grant requirements.

NOTE

This section on lobbying restrictions only applies to nonprofit CAAs as 501(c)(3) tax-exempt organizations and as recipients of federal funds. Public CAAs should refer to *Section F. Lobbying of Chapter One: Overview of Federal Grant Law* for a discussion of the lobbying restrictions that apply to them.

IRS Rules

As 501(c)(3) tax-exempt organizations, nonprofit CAAs may engage in limited lobbying, so long as the lobbying does not constitute a "substantial part" of the organization's activities. A nonprofit CAA may choose to comply with this limitation either by applying the "substantial part" test or by making what is known as a "501(h) election."



“Substantial Part” Test

Under this test, the IRS considers whether, subjectively, lobbying activities constitute a “substantial part” of the organization’s activities. How much time and money constitute a “substantial part,” however, is not well-defined. In assessing whether lobbying constitutes a “substantial part” of the organization’s activities, the IRS balances the significance of the lobbying activities against the objectives and circumstances of the organization as a whole, rather than looking solely at the time or money spent. Under this test, nonprofit CAAs will need to track both time or money spent toward lobbying. CAAs must answer questions on their Forms 990 about the specific types of activity performed, including volunteer time and other unpaid activities, as well as their lobbying expenditures. If the IRS finds that a nonprofit CAA engaged in substantial lobbying in a single year, it can revoke the CAA’s 501(c)(3) status.

501(h) Election

In lieu of the “substantial part” test, nonprofit CAAs may elect to be subject to specific, defined expenditure limits under section 501(h) of the Code by submitting IRS Form 5768. An organization that makes this

...if a CAA makes a 501(h) election, it only needs to track the amounts the organization spends on lobbying.

501(h) election may spend up to a specified dollar threshold on lobbying expenditures. Unlike with the “substantial part” test, if a CAA makes a 501(h) election, it only needs to track the amounts the organization spends on lobbying. This means that there are no limits on a CAA’s lobbying activities that do not incur expenses (e.g., the CAA does not have to report or track the time or expenses its volunteers spend on lobbying if the CAA doesn’t reimburse those expenses.)

The 501(h) election also distinguishes between grassroots and direct lobbying. Grassroots lobbying is seeking to influence legislation by affecting the opinions of the general public, which may be accomplished by (i) referring to specific legislation, (ii) reflecting a view on such legislation, and (iii) encouraging a person to take action with respect to such legislation.²⁸ Grassroots lobbying may encourage listeners to take action by identifying one or more legislators and sharing their views on a particular legislation, or providing a legislator’s contact information or other materials for recipients to use to communicate with a legislator.

Direct lobbying is seeking to influence legislation by communicating directly with any member or employee of a legislative body with the purpose of influencing legislation.²⁹ Such communication must be made with the intent to affect the outcome of a specific piece of legislation. For example, inviting a state senator to tour a CAA’s job training program and explaining the program and needs of its clients would not, on its own, be considered direct lobbying. The CAA may even ask the legislator to hold a hearing on the job training needs

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of its community, but this communication would not be considered direct lobbying unless the CAA discusses any pending or proposed legislation. However, asking the legislator to support continued or increased funding of the job training program during the tour, even if no budget bill has been introduced, constitutes direct lobbying, as it would be reasonable to assume that the legislature will introduce and pass an appropriations statute each year.

Limits on lobbying expenditures under the 501(h) election are calculated based on a percentage of the amount the CAA spends in a given year to further its charitable purpose (called its “exempt purpose expenditures”). Penalties on excess expenditures can be significant: a CAA will be subject to a 25% excise tax on any amount exceeding this limit, and if the CAA’s total lobbying expenditures exceed 150% of the limit over four years, the IRS will revoke the organization’s tax-exempt status. Under the 501(h) election, grassroots lobbying costs are subject to separate expenditure limits, though grassroots lobbying expenditures also count towards the CAA’s total lobbying expenditure limit. Once a CAA makes a 501(h) election, it is valid for the current and subsequent tax years until the CAA revokes it by filing another Form 5768 in a subsequent tax year.

This table compares requirements of the substantial part test and those of the 501(h) election:

Issue	“Substantial Part” Test	501(h) Election
Limits on Total Lobbying Expenditures	Lobbying cannot be a “substantial” part of the organization’s activities. It is a subjective test that weighs all of the facts and circumstances.	20% of the first \$500,000 of “exempt purpose expenditures,” with decreasing percentages of expenditures above \$500,000, up to a cap of \$1 million, may be spent on lobbying.
Limits on Grassroots Lobbying Expenditures	Lobbying cannot be a “substantial” part of the organization’s activities. It is a subjective test that weighs all of the facts and circumstances.	25% of the first \$500,000 of total lobbying nontaxable expenditures, with decreasing percentages of expenditures above \$500,000, up to a cap of \$250,000, may be spent on grassroots lobbying.
Form 990 Reporting	Detailed description of the legislative activities and a classified schedule of the expenses paid or incurred.	Only numbers are required: grassroots and total lobbying expenditures, along with percentages of “exempt purpose expenditures” that these expenditures comprise.
Recordkeeping	Must document all lobbying activities and expenses of both employees and volunteers (e.g., board members).	Must document lobbying expenses, both grassroots and direct.
Reporting Lobbying Time and Expenses by Volunteers	Organization must track and report on its Form 990 both the time and expenses incurred by volunteer lobbying activities.	Organization only needs to track and report on its Form 990 any unreimbursed expenses spent on lobbying activities by its volunteers.

Issue	"Substantial Part" Test	501(h) Election
Revocation of Tax-Exempt Status	If "substantial" lobbying in any one year. (no bright-line rule for what is "substantial")	If lobbying exceeds 150% of the total lobbying expenditure limit over four years.
Penalty to Org. for Excessive Lobbying	5% of lobbying expenditures for the year in which tax-exempt status is revoked for "substantial" lobbying.	25% excise tax on excess over (i) total lobbying expenditure limits and (ii) grassroots lobbying expenditure limits.
Penalty to Org. Officers/ Directors for Excessive Lobbying	Joint and several liability for a tax equal to 5% of lobbying expenditures for that year on those who agree to making the expenditures, knowing that the expenditures would likely result in the loss of tax-exempt status.	No specific liability.

A nonprofit CAA that does not make a 501(h) election will, by default, be subject to the "substantial part" test. Thus, if a CAA plans to engage regularly in lobbying, it should consider making a 501(h) election. To ensure compliance with the lobbying limitations and reporting requirements,³⁰ nonprofit CAAs should put systems in place to track their lobbying expenditures and, for CAAs that do not make the 501(h) election, lobbying activities generally.

What Doesn't Count as Lobbying: Four Exceptions Under IRS Rules

The IRS regulations define four basic exceptions to the definition of lobbying communications.³¹ This means that a tax-exempt organization does not need to count time and expenditures spent on the following types of activities towards its lobbying expenditure limits.

- **Nonpartisan Analysis, Study, or Research.** This exception allows a tax-exempt organization to publish educational materials that both refer to and reflect a view on specific legislation, so long as the materials provide a full and fair presentation of the underlying facts such that the audience can form an independent opinion or conclusion about the subject. The materials cannot directly encourage the reader to take lobbying action with respect to the specific legislation, and the educational materials must be widely disseminated and made available to the general public. Generally-speaking, qualifying materials will be contained in speeches, legislative testimony, reports, and booklets; advertisements and "fact sheets," on the other hand, will probably not be sufficiently detailed to qualify for this exception.
- **Examinations and Discussions of Broad Social, Economic, and Similar Problems.** This exception allows a tax-exempt organization to engage in discussions with members of legislative bodies or governmental employees about general topics that are also the subject of specific legislation, so long as the organization does not refer to the specific legislation or directly encourage the listener to take legislative action. For example, participating in community meetings with state legislators to discuss general issues of affordable housing would probably qualify for this exception.
- **Requests for Technical Advice.** Under this exception, a tax-exempt organization can respond to a written request by a legislative body, committee, or subcommittee, so long as the response is provided to all members of the body making the request. Thus, for example, providing technical

advice to an individual legislator would not qualify for the exception, while testifying before a full legislative subcommittee would.

- **Self-Defense Communications.** This exception allows a tax-exempt organization to communicate with a legislative body regarding possible actions that could affect the organization's existence, powers, duties, tax-exempt status, or the deductibility of contributions to the organization. For example, lobbying the legislature to vote against a bill that would jeopardize the organization's tax-exempt status qualifies under the "self-defense" communication exception. IRS regulations, however, have clarified that attempts to persuade a legislative body to continue funding a program through the annual appropriations bill does not constitute self-defense and thus, such communications would count towards the organization's lobbying expenditure limits.

Federal Grant Restrictions

As previously noted, in *Section F. Lobbying of Chapter One: General Overview of Federal Grant Law* nonprofit CAAs are generally **prohibited** from using federal grants funds to lobby.³² Under the federal cost principles in the Uniform Guidance, lobbying activities include (i) attempting to influence the outcomes of any federal, state, or local election, referendum, or initiative through in-kind or cash contributions, endorsements, publicity, or similar activity, (ii) introducing or attempting to influence, enact, or modify federal or state legislation, or (iii) attending legislative sessions or committee hearings in an effort to engage in lobbying.³³

Additionally, federal appropriations statutes may further restrict a CAA's ability to use federal funds to influence administrative action or local legislation. The Consolidated and Further Continuing Appropriations Act, 2016, P.L. 114-113, for example, prohibits the use of U.S. Department of Health and Human Services (HHS) grant funds to:

pay the salary or expenses of any grant or contract recipient, or agent acting for such recipient, related to any activity designed to influence the enactment of legislation, appropriations, regulation, **administrative action**, or Executive order proposed or pending before the Congress or any State government, State legislature or **local legislature or legislative body**, other than for normal and recognized executive-legislative relationships or participation by an agency or officer of a State, local or tribal government in policymaking and administrative processes within the executive branch of that government.³⁴

Further, while a nonprofit CAA may, under certain circumstances, use federal funds to prepare and submit grant applications as well as to engage in technical discussions about the proposals prior to their official submission, the Byrd Amendment³⁵ prohibits using federal funds to attempt to influence federal employees in connection with the awarding of federal grants. CAAs must submit a certification form when applying for federal grants regarding compliance with the Byrd Amendment.³⁶



In addition to the four IRS-issued exceptions to what counts as lobbying, described in the section above, certain lobbying activities may also fall within one or more narrow exceptions under the Uniform Guidance.³⁷ These exceptions are described further in *Section F. Lobbying—Narrow Exceptions for Federal Grant Funds* in *Chapter One: General Overview of Federal Grant Law*. The Uniform Guidance explicitly incorporates the four IRS-issued exceptions. Note, however, that recent federal appropriations statutes that have prohibited federal grant recipients from using federal funds to engage in lobbying activities have **not** incorporated the exceptions under the Uniform Guidance. A federal appropriations statute will trump the Uniform Guidance. Thus, for example, where the HHS appropriations statute for a particular year prohibits using HHS funds to lobby and does not include the exceptions contained in the Uniform Guidance, CAAs must follow the HHS prohibition with respect to HHS funds. As a general matter, CAAs should avoid using their federal funds to lobby.

Lobbying by a Nonprofit CAA

A nonprofit CAA, as a 501(c)(3) tax-exempt organization, can lobby – it just generally cannot use any resources paid out of federal funds, including staff time, supplies, equipment, postage, or space, for lobbying activities. Moreover, CAAs may not use program income or federal matching funds to lobby.

PRACTICE TIPS

When Conducting Lobbying Activities:

Use non-federal, unrestricted funds to lobby. CAAs should only use non-federal, unrestricted funds for any expenditures made in relation to lobbying activities. Any staff member who is primarily responsible for lobbying should be paid, in part or in whole, out of the CAA’s non-federal, unrestricted funds. If a staff member only spends a limited amount of time at work engaged in lobbying, the CAA should pay that portion of the staff member’s salary using non-federal, unrestricted funds.

Track time spent by employees lobbying. CAAs should track employee lobbying time on a time card on an ongoing basis or as an “exception report” when the employee engages in lobbying activities. The CAA must report this time on its Form 990.

Do not include lobbying costs as part of the indirect cost pool. If a CAA has a federally negotiated indirect cost rate, the CAA must separately identify lobbying costs as direct costs in the CAA’s indirect cost rate proposal.

Lobby on personal time, without using CAA resources. Employees are free to lobby on their personal time without using any CAA resources.

Be careful when asking non-exempt employees to volunteer to lobby. CAAs should be aware that they must pay employees who are not exempt from overtime pay under the federal Fair Labor Standards Act (FLSA) for their volunteer lobbying efforts if (i) they are asked or required to lobby or (ii) if the lobbying relates to their paid job. Failure to do so may result in wage and hour law violations.

Lobby using board members or other volunteers. CAAs may use board members or other volunteers to lobby. However, as discussed above, volunteer time is a factor used to determine if a 501(c)(3) tax-exempt organization has engaged in a substantial amount of lobbying if the CAA has not opted out of the default, “substantial part” test. Therefore the time spent must be tracked and reported on the CAA’s Form 990.

E. Political Campaign Activities

Section 501(c)(3) organizations are subject to restrictions that govern a nonprofit CAA's ability to engage in political campaign activities. Moreover, because nonprofit CAAs receive federal funding, they are subject to various additional restrictions under (i) some authorizing statutes for federal awards, (ii) the federal appropriations acts funding the federal awards, (iii) the OMB federal cost principles, and (iv) the federal award terms and conditions.

Generally speaking, **political campaign activities** include participating or intervening, directly or indirectly, in a campaign for public office, making contributions to a political campaign or party, and conducting voter registration drives or other get-out-the-vote campaigns. The facts and circumstances of the nonprofit CAA's conduct will matter, and CAAs should understand the rules that apply and seek the advice of outside counsel, if necessary, prior to engaging in any such activities.

The main takeaway for a nonprofit CAA with respect to political campaign activity is that, as a 501(c)(3) tax-exempt organization, a nonprofit CAA may not support or oppose candidates for public office. However, a nonprofit CAA may engage in specific nonpartisan political activities under the IRS rules and when doing so must not use either CSBG Head Start or other federal funds to pay for resources or staff used to conduct such activities and the CAA's CSBG program may not be identified with such activities. The CAA will need to check with its other federal funding sources to determine if the funds received from them may be used for the nonpartisan political activities permitted under the IRS rules. Moreover, some CAA employees will be prohibited from engaging in a few, specific political activities outside of work (in addition to during work) because of the Hatch Act, which generally applies when either CSBG Act or Head Start Act funds are used to pay a portion of an employee's salary and finance a portion of the activities that the employee is working on.

NOTE

This section on the political activity restrictions only applies to nonprofit CAAs as 501(c)(3) tax-exempt organizations and as recipients of federal funds. Public CAAs should refer to *Section G. Political Campaign Activities of Chapter One: General Overview of Federal Grant Law* for a discussion of the political campaign activity restrictions that apply to them.

IRS Rules

Under IRS rules, 501(c)(3) tax-exempt organizations may not directly or indirectly participate or intervene in any political campaign on behalf of or in opposition to a candidate for public office at any level—federal, state, or local.³⁸ Other political activities are permitted if they are nonpartisan and do not favor any particular candidate, but the facts and circumstances of the nonprofit CAA's conduct will matter. A few examples of permissible nonpartisan political activities that apply generally to all 501(c)(3) tax-exempt organizations are



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discussed below, and additional information and examples may be found in [IRS Revenue Ruling 2007-41](#). However, nonprofit CAAs must also be aware of the restrictions (discussed in greater detail in the section entitled “Federal Funds and Political Campaign Activities” below) imposed by the federal CSBG Act (and for CAAs with Head Start programs, the federal Head Start Act), including the Hatch Act restrictions incorporated by reference into both acts.

Voter Education, Registration, or Encouragement

A nonprofit CAA, as a 501(c)(3) tax-exempt organization, may conduct voter drives or educational activities so long as they are carried out in a nonpartisan and unbiased manner. A nonprofit CAA may set up a voter registration booth if references to any candidate or party are not made; however, it may not use either its CSBG Act or Head Start Act funds to pay for any resources or staff used in connection with the nonpartisan activity and, as discussed in greater detail below, the CAA’s CSBG program may not be identified with such activities.

Individual Activity By Organization Leaders

Leaders of a nonprofit CAA, including members of the board of directors and officers, may generally engage in political activities when speaking for themselves as individuals, rather than on behalf of the organization. For example, the executive director of a CAA would likely be permitted to appear in a political candidate’s campaign advertisement so long as the advertisement did not identify him or her as being employed by the CAA. However, the executive director may not make comments in support of or opposition to candidates for public office in official organization publications or at official organization meetings and functions. Moreover, if the organization’s leader is subject to the Hatch Act, as described in greater detail below, he or she will not be able to engage in certain political campaign activities even during his/her personal time outside of work.

Candidate Appearances

Nonprofit CAAs, as 501(c)(3) tax-exempt organizations, may invite political candidates to speak at events, but should be cautious when doing so. Candidates may appear together or at separate times, but the CAA should invite all candidates in writing and give them each an equal opportunity to speak. CAAs may not support or oppose, either directly or indirectly, any candidate, and may not conduct political fundraising at the event. For example, a CAA may host a candidate forum conducted in a neutral, nonpartisan manner where all candidates are invited. An independent panel, not the CAA, should prepare the questions and the panel should cover a broad range of topics. Additionally, the moderator should not express explicit or implicit approval or disapproval of any of the candidates. A CAA must not pay for such activities using either its CSBG Act or Head Start Act funds and must be careful that its CSBG program is not identified with such activities, as discussed below in greater detail.



Candidate Appearances in a Non-Candidate Capacity

Nonprofit CAAs may invite candidates to speak to the CAA in their non-candidate capacity (e.g. as an incumbent officeholder) if the candidate has a legitimate reason to do so, but the CAA should not invite them close to election time. Further, the CAA should not mention a candidate's campaign at the event and should ensure that neither the candidate nor the CAA conducts political fundraising at the event.

Websites

A nonprofit CAA is responsible for the content of its own website as well the links it establishes and maintains to other websites, even if the CAA does not have control over the content of the linked sites. Links

Links to candidate-related material, on their own, do not necessarily constitute partisan political activity.

to candidate-related material, on their own, do not necessarily constitute partisan political activity. The IRS will consider all of the facts and circumstances surrounding the link, including whether (i) there is any exempt purpose served by the link, (ii) the context surrounding the link on the CAA's website, (iii) the relatedness between the link and the webpage containing political opinions, and (iv) the degree to which all candidates are represented. For example, if a CAA's website includes a link to an online newspaper article

discussing one of the CAA's programs, and the online newspaper happens to contain editorials endorsing particular candidates elsewhere on its website, the CAA most likely has not violated the political campaign intervention prohibition.

Federal Grant Restrictions

CSBG and Head Start funds

Organizations receiving CSBG and Head Start funds are limited in their ability to engage in any political activity. Under the CSBG Act,³⁹ a nonprofit CAA may **not** use CSBG funds to carry on programs, provide services, or employ/assign personnel in a manner supporting or even resulting in the CSBG programs being identified with: (i) any partisan or nonpartisan political activity, including any political activity associated with a candidate or group in an election for public or party office; (ii) any activity to provide transportation to the polls; or (iii) any voter registration activity.⁴⁰ In [Information Memorandum No. 81](#), the federal Office of Community Services, the federal agency that administers CSBG, reiterates that CAAs and other entities receiving CSBG funds cannot conduct CSBG-funded programs or provide CSBG-funded services in a manner that could result in the identification of such programs or services with the prohibited political activities.

Similarly, the Head Start Act⁴¹ prohibits individuals employed by or otherwise assigned to Head Start programs from, during work hours, (i) engaging in any partisan or nonpartisan political activity, including any political activity associated with a candidate, or group, in an election for public or party office or (ii) providing transportation to the polls or similar assistance.⁴² Further, a CAA may not use Head Start funds to conduct voter registration activities. However, Head Start-funded organizations may permit nonpartisan entities to run such activities on Head Start-funded facilities during normal hours of operation. For example, a CAA could allow the League of Women Voters, a nonpartisan entity, to conduct voter registration at its Head Start-funded facilities at times when parents will be dropping off and picking up their children.

Under the Uniform Guidance, the federal cost principles, which apply to both CSBG and Head Start funds, specifically prohibit CAAs from using federal funds to contribute to political parties, campaigns, or political action committees (PACs).⁴³



Hatch Act Restrictions

The Hatch Act typically only restricts the political activity of individuals who are principally employed by federal, state, or local governments and who work in connection with programs financed in whole or in part by federal loans or grants. While employees of 501(c)(3) nonprofit organizations that receive federal funds generally are not subject to the Hatch Act, the Hatch Act applies to nonprofit CAAs because it is incorporated by reference into the CSBG and Head Start Acts, and to date, they are the only federal grant statutes do so. *All of the Hatch Act restrictions discussed below apply regardless of whether the employee conducts the restricted activity during work time or on the employee's personal time, even if the employee is on a paid or unpaid leave of absence.* Two types of employees of nonprofit CAAs are restricted under the Hatch Act.

The **FIRST TYPE** of employee restricted by the Hatch Act is one who:

- either (i) spends more than half of his/her total work time employed by a CAA or Head Start grantee or (ii) receives more than half of his/her total wages from the CAA or Head Start grantee; and
- works in connection with activities financed by CSBG and/or Head Start funds.⁴⁴

For example, an employee who is employed full-time for a nonprofit CAA but works solely for the CAA's weatherization program fully funded by U.S. Department of Energy grants would not be covered by the Hatch Act.

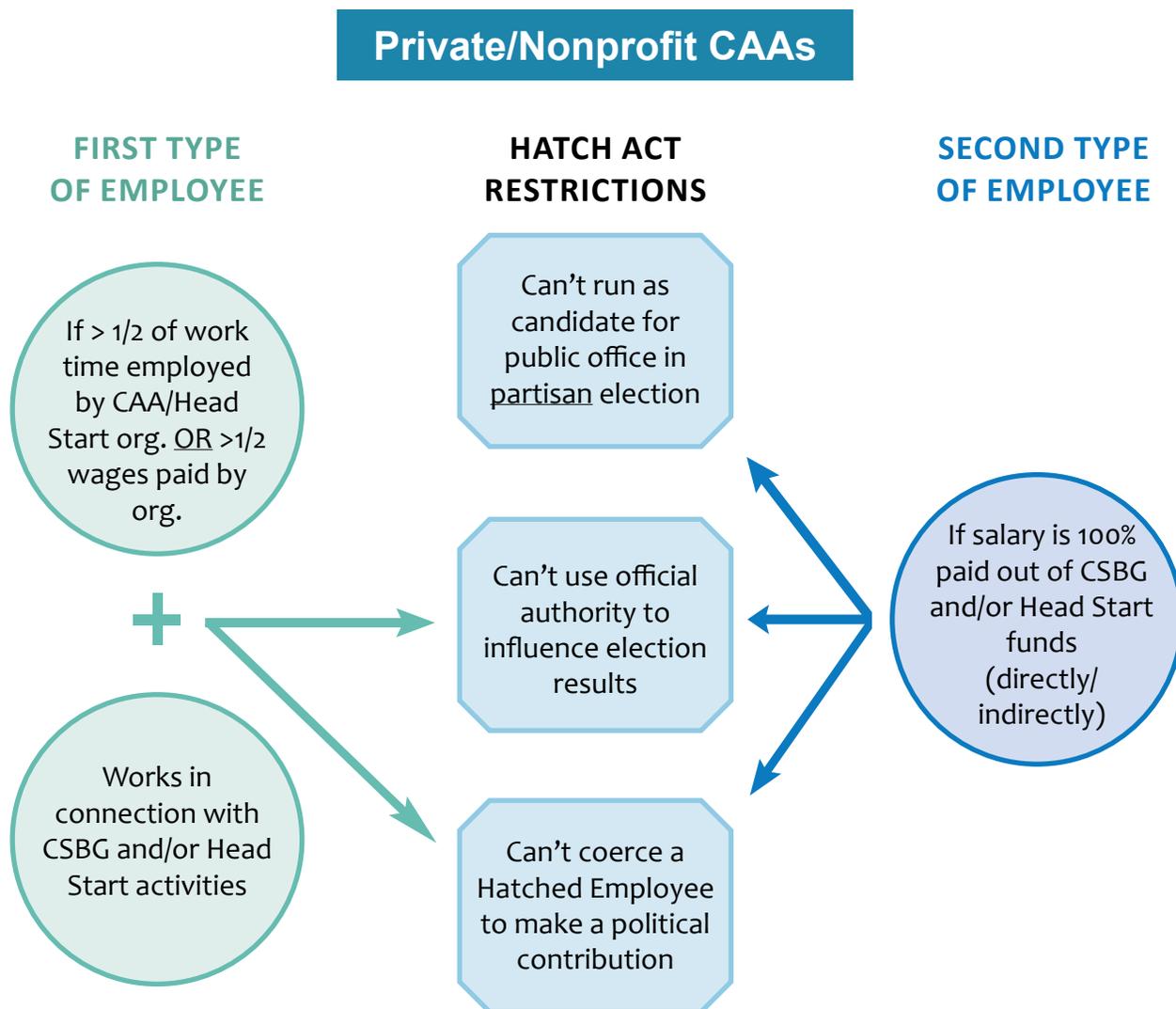
This first type of employee is subject to the following two restrictions:

- He/she may not use his/her official authority to influence or interfere with or affect the results of an election or nomination for office; and
- He/she may not directly or indirectly coerce, attempt to coerce, command, or advise another employee covered under the Hatch Act (a Hatched Employee) to make political contributions to candidates, PACs, or political parties.⁴⁵ Supervisors who ask for political contributions from their subordinates are deemed to have indirectly engaged in coercion.

The **SECOND TYPE** of employee who is restricted under the Hatch Act is one whose salary is paid entirely out of CSBG or Head Start funds or entirely out of a combination of CSBG and Head Start funds. In addition to being subject to the restrictions above that apply to the first type of employee,⁴⁶ this second type of employee also may not be a candidate for public office in a partisan election.⁴⁷ Generally speaking, "partisan" elections are those in which at least one candidate is nominated by, represents, is supported by, or associates himself or herself with a party whose Presidential candidate received votes in the last election, or if any of

the candidates are identified on the ballot with a political party.⁴⁸ Elections are also deemed “partisan” for the purposes of Hatch Act if state or local laws designate them as such.

This graphic helps to illustrate the two types of employees and the applicable Hatch Act restrictions:



It is important to note that both types of employees covered by the Hatch Act may, on their own time and outside of the workplace, (i) run for office in a nonpartisan election,⁴⁹ (ii) continue to serve in the offices to which they were elected prior to becoming subject to Hatch Act restrictions, so long as they are not currently seeking re-election as a candidate in a partisan election,⁵⁰ (iii) run for and hold office in a political party,⁵¹ and (iv) participate in political campaigns, party organizations, and make and solicit contributions.⁵²

If a federal awarding agency has reason to believe that an employee covered by the Hatch Act has violated the prohibited activities under the Hatch Act, it must report the matter to the U.S. Office of Special Counsel (OSC), the federal agency responsible for investigating and prosecuting Hatch Act violations.⁵³ The OSC will investigate the report and both the employee and the CAA are entitled to a hearing before the Merit Systems Protection Board, which will adjudicate the report.⁵⁴ If the Merit Systems Protection Board determines that a Hatch Act violation exists, it may require the organization to forfeit its federal funding in an amount equal to

two years of the employee’s salary at the time of the Hatch Act violation. In determining the seriousness of the offense, the OSC looks at the extent to which an employee knowingly violated the statute and whether the employee received a warning from OSC or the CAA’s funding source prior to the violation.

F. Private Inurement and Private Benefit

A 501(c)(3) tax-exempt organization must engage in activities that further its tax-exempt purpose, or it jeopardizes its tax-exempt status and its eligibility to receive tax-deductible contributions. Section 501(c)(3) of the Code provides that to qualify for exemption from federal income tax, no part of the organization’s net earnings may inure to the benefit of any private shareholder or individual.⁵⁵ Thus, the purpose of the private inurement and private benefit rules are to ensure that charitable assets of a tax-exempt organization are used to benefit the public and are not diverted to benefit private individuals. The IRS distinguishes between “private inurement” and “private benefit” transactions based on who is benefiting from the activity.

Private Inurement

Private inurement occurs when an insider receives a “disproportionate share of the benefits of the exchange relative to the exempt purposes served” in a transaction between an insider and the nonprofit organization.⁵⁶ Insiders typically include officers, directors, key employees, and other individuals with significant influence over the organization’s operations. The IRS does not prohibit transactions between a tax-exempt organization and an insider,⁵⁷ but the transactions must be reasonable and may not disproportionately benefit the individual.

Examples of private inurement include the payment of dividends or unreasonable executive compensation to insiders (e.g., the executive director of the CAA), excessive employee benefits, interest-free loans, and rental arrangements, or other transfers of property for less than fair market value. The IRS imposes an absolute prohibition against private inurement. The lack of a de minimis concept is one of the key differences between the private inurement and private benefit rules.

If the IRS finds that there are private inurement, it can invoke what are called “intermediate sanctions,” forcing the insider to return the unreasonable portion of the benefit to the nonprofit and to pay an excise tax. The managers who approved the transaction may also be required to pay a penalty. However, if the organization follows certain steps, the transaction will be presumed to be reasonable.

Rebuttable Presumption: A transaction is presumed reasonable if:	
✓	“Independent” board members (i.e., individuals who did not have conflicts of interest with respect to the transaction or arrangement) approved the transaction in advance;
✓	The board obtained in advance and relied on appropriate data as to comparability of the transaction’s price with market values; and
✓	The board adequately documented the basis for its determination contemporaneously with approving the transaction.

The IRS has the right to challenge (or “rebut”) the presumption that a transaction is reasonable. If the organization does not follow the steps to meet the rebuttable presumption, the transaction is not automatically unreasonable or considered an “excess benefit transaction,” but the organization will have the burden of proving the reasonableness of the transaction.

In addition to imposing excise taxes pursuant to intermediate sanctions, the IRS may also revoke the organization’s tax-exempt status in certain cases involving private inurement.

Adopting and implementing a conflict of interest policy may help tax-exempt organizations prevent private benefit and private inurement transactions, and thus help protect an organization’s tax-exempt status. A conflict of interest policy typically includes procedures for the following: (i) disclosure by persons having a financial interest; (ii) determining whether the financial interest of a person may result in a conflict of interest; (iii) addressing the conflict of interest after determining that it exists; (iv) keeping adequate records of actions taken; and (v) ensuring that the policy is distributed to all board members, principal officers, and other persons in authority.

Private Benefit

The concept of “private benefit” comes from IRS regulations that provide that an organization is not organized and operated exclusively for one or more charitable purposes “unless it serves a public rather than a private interest.” This means that an organization will not qualify for 501(c)(3) tax-exemption if it ultimately serves private interests. “Private benefit” is a different concept from “private inurement.”

Unlike the private inurement rule, which only applies to insiders of the organization, the private benefit rule is broader in its scope and covers transactions with all persons and entities, including “disinterested” parties and “outsiders.” Also, unlike with the private inurement rules, a normal, or de minimis, amount of private benefit is permissible. As long as the private benefit is incidental to the furtherance of the organization’s exempt purpose (i.e., the public benefit), the private benefit is permissible and will likely not jeopardize the organization’s tax-exempt status. A private benefit is considered incidental if: (i) the private benefit is necessary to confer the public benefit (e.g., the benefit to the public cannot be achieved without benefiting certain private individuals); and (ii) the private benefit is insubstantial compared to the public benefit conferred.⁵⁸ The particular facts and circumstances of a situation will determine whether a private benefit meets each of these conditions.

Similarly to private inurement, excessive private benefit transactions may lead to the revocation of an organization’s tax-exempt status.

G. Form 990

All nonprofit CAAs organized as 501(c)(3) tax-exempt organizations are required to file a federal annual report on Form 990 with the IRS. This form provides the IRS with information on the organization’s mission, programs, and finances and after filing, is generally made available to the public for inspection. The general public often relies on the Form 990 as a primary or sole source of information about a particular organization. Thus, information an organization presents on its annual return may influence how the public perceives it.

Form 990-T

Tax-exempt organizations with gross unrelated business income of \$1,000 or more must also file a Form 990-T and attach any required supporting schedules and forms. Form 990-T is due at the same time the



organizations Form 990 is due. Certain states also impose a tax on unrelated business income and may require additional tax filings. See *Section B. Unrelated Business Income* in this *Chapter Four: General Tax-Exempt Law Requirements* for additional information.

Filing Deadlines and Extensions

The Form 990 must be filed by the 15th day of the 5th month after the organization's accounting period ends (e.g., if a CAA's fiscal year ends on December 31st, its Form 990 is due on May 15th of the following year). If the due date falls on a Saturday, Sunday, or legal holiday, the filing is due on the next business day. Organizations may request an automatic three-month extension of time to file using Form 8868, *Application for Extension of Time to File an Exempt Organization Return*, and an additional three-month extension upon showing reasonable cause for the additional time requested. For filings for fiscal year 2016 and beyond, organizations may request an automatic six-month extension.

Penalties for Failure to File

The IRS will assess a penalty for late filings of \$20 a day, not to exceed the lesser of (i) \$10,000 or (ii) 5% of the gross receipts of the organization for the year, unless the organization can show reasonable cause for the late filing. Organizations that are required to file electronically but do not do so are deemed to have failed to file the return, even if they submit a paper return. The IRS will also charge a penalty if the organization files an incomplete return, such as by failing to complete a required line item or a required part of a schedule.

PRACTICE TIPS

To avoid penalties on Form 990 filings:

- Complete** all applicable line items;
- Answer** each question on the Form 990, unless instructed to skip a line;
- Make an entry** (including a zero when appropriate) on all lines requiring an amount or other information to be reported; and
- Provide** required explanations as instructed.

If an organization fails to file the required Form 990 for three consecutive years, the IRS will automatically revoke the organization's tax-exempt status on and after the due date for filing its third annual Form 990. Organizations that lose their tax-exempt status may need to file income tax returns and pay income tax, but may apply for reinstatement of exemption.

The IRS website contains detailed instructions on completing and filing the Form 990 that a nonprofit CAA should review prior to submitting the filing. Nonprofit CAAs should also check for any annual return requirements under their state nonprofit corporation statutes to ensure they are complying with all state filing requirements.

H. Required Disclosures

Public Inspection and Copying Requirements

Nonprofit CAAs must make the following information available for public inspection and/or copying:

- **Annual information return (Form 990).** An organization must make its annual Form 990 filing available for public inspection and copying for three years, beginning on the date the return is required to be filed or is actually filed, whichever is later. All schedules, attachments, and supporting documents filed with the IRS should be available for public inspection and copying. An organization does not need to disclose the names and addresses of contributors, but all other information, including the amount of contributions, and the description of non-cash contributions is releasable unless it identifies the contributor.
- **UBI tax returns (Form 990-T).** An organization must make available for public inspection and copying its Form 990-T, which is used to report any unrelated business income generated over \$1,000.
- **Exemption application (Form 1023).** An organization must make available for public inspection its Form 1023 exemption application, together with all documents the IRS requires the organization to submit in support of its application. The organization must also make available for public inspection and copying its exemption ruling letter issued by the IRS.

Anyone may request to view and/or copy the documents described above during regular business hours at the organization's principal business office and also at the organization's regional or district offices, provided that the organization has three or more employees. The organization must provide a copy of all or any part of an application or return without charge, other than a reasonable fee for reproduction and postage costs. Organizations may place reasonable restrictions on the time, place, and manner of in-person inspection and copying.

A tax-exempt organization does not have to comply with requests for copies of its annual return, Form 990-T, and exemption application if it makes them widely available. The organization can make its application and returns widely available by posting the application and returns on the internet. Organizations that do so should redact the names and addresses of contributors. The organization must notify any individual requesting a copy where the documents are available, including the web address, if applicable. For requests made in person, the organization must provide the notice immediately. For requests made in writing, the organization must provide the notice within seven days.

Penalties

A person who fails to make an annual return available for inspection and/or copying must pay a penalty of \$20 each day for as long as the failure continues, up to \$10,000 per return. For the exemption application, the penalty is \$20 per day, with no limit on the total amount of the penalty. No penalty will be imposed if the failure is due to reasonable cause.

Notes

¹ 26 U.S.C. § 501(c)

² I.R.C. §§ 511-512

³ I.R.C. 511(a)(1)

⁴ IRS Publication 598, *Tax on Unrelated Business Income of Exempt Organizations*

⁵ Treas. Reg. § 1.513-1(c)(2)(iii); 26 C.F.R. § 1.513-1(c)(2)(iii)

⁶ Treas. Reg. § 1.513-1(c)(2)(iii); 26 C.F.R. § 1.513-1(c)(2)(iii)

⁷ IRS Publication 598, *Tax on Unrelated Business Income of Exempt Organizations*

⁸ I.R.C. § 513(a)(1)

⁹ I.R.C. § 513(a)(2)

¹⁰ I.R.C. § 513(a)(3)

¹¹ IRS Publication 598, *Tax on Unrelated Business Income of Exempt Organizations*

¹² I.R.C. § 513(d)

¹³ Treas. Reg. § 1.513-3(a)

¹⁴ Under I.R.C. § 512(b)(13)(D), an entity is deemed to be “controlled” if: (i) for a corporation, the controlling organization owns (by vote or value) more than 50% of the stock, (ii) for a partnership, the controlling organization owns more than 50% of the profits or capital interests, or (iii) for any other organization, the controlling organization owns more than 50% of the beneficial interest. For this purpose, constructive ownership of stock (determined under I.R.C. § 512(b)(13)(D)(ii)) or other interests is taken into account. As a result, an exempt parent organization is treated as controlling any subsidiary in which it holds more than 50% of the voting power or value, whether directly (as in the case of a first-tier subsidiary) or indirectly (as in the case of a second-tier subsidiary).

¹⁵ I.R.C. § 514(a)(1)

¹⁶ Treas. Reg. § 1.514(b)-1(b)(ii); 26 C.F.R. § 1.514(b)-1(b)(ii)

¹⁷ Treas. Reg. § 1.514(b)-1(b)(ii); 26 C.F.R. § 1.514(b)-1(b)(ii)

¹⁸ Treas. Reg. § 1.513-4(c)(2)(v); 26 C.F.R. § 1.513-4(c)(2)(v)

¹⁹ Treas. Reg. § 1.513-4(c); 26 C.F.R. § 1.513-4(c)

²⁰ I.R.C. § 513(i)(1)

²¹ Treas. Reg. § 1.513-4(c)(2)(iv); 26 C.F.R. § 1.513-4(c)(2)(iv)

²² Treas. Reg. § 1.170A-13; 26 C.F.R. § 1.170A-13

²³ Treas. Reg. § 1.170A-13(a); 26 C.F.R. § 1.170A-13(a)

²⁴ Treas. Reg. § 1.170A-13(f); 26 C.F.R. § 1.170A-13(f)

²⁵ Treas. Reg. § 1.170A-13(f)(8)(i)(A); 26 C.F.R. § 1.170A-13(f)(8)(i)(A)

²⁶ Treas. Reg. § 1.170A-13(f)(10); 26 C.F.R. § 1.170A-13(f)(10)

²⁷ See, e.g., Consolidated and Further Continuing Appropriations Act, 2015, P.L. 113-235, Division G – Departments of Labor, Health and Human Services, and Education, and Related Agencies Appropriations Act, 2015, Title V, Sections 503(a) - (b).

²⁸ 26 C.F.R. § 56.4911-2

²⁹ 26 C.F.R. § 56.4911-2

³⁰ 26 C.F.R. § 56.4911-1(c)

³¹ 26 C.F.R. § 56.4911-2(c)

³² Byrd Amendment, 31 U.S.C. § 1352; Uniform Guidance, 2 C.F.R. § 200.450(c)

³³ 2 C.F.R. § 200.450(c)

³⁴ Consolidated and Further Continuing Appropriations Act, 2015, P.L. 113-235, Division G – Departments of Labor, Health and Human Services, and Education, and Related Agencies Appro-

priations Act, 2015, Title V, Sections 503(a) - (b) (emphasis added).

³⁵ 31 U.S.C. § 1352

³⁶ See, e.g., 45 C.F.R. § 93.110 for the regulations applicable to HHS grants

³⁷ 2 C.F.R. § 200.450(c)(2)

³⁸ I.R.C. § 501(c)(3)

³⁹ 42 U.S.C. §§ 9901 et. seq.

⁴⁰ 42 U.S.C. § 9918(b)(2)

⁴¹ 42 U.S.C. §§ 9801 et. seq.

⁴² 42 U.S.C. § 9851(b)

⁴³ 2 C.F.R. § 200.450(c)

⁴⁴ 5 U.S.C. § 1501(4)

⁴⁵ 5 U.S.C. § 1502(a)(1)-(2); 5 C.F.R. § 151.121

⁴⁶ 5 U.S.C. § 1502(a)(1)-(2); 5 C.F.R. § 151.121(a)-(b)

⁴⁷ 5 U.S.C. § 1502(a)(3)

⁴⁸ 5 U.S.C. § 1503; 5 C.F.R. § 151.101(h)

⁴⁹ 5 U.S.C. § 1503

⁵⁰ 5 U.S.C. § 1502(c)(4); 5 C.F.R. § 151.122

⁵¹ 5 C.F.R. § 151.111(a); U.S. Office of Special Counsel Advisory Opinion 2002-06-04

⁵² 5 C.F.R. §§ 734.205, 734.208

⁵³ 5 U.S.C. § 1504

⁵⁴ 5 U.S.C. §§ 1504-1505

⁵⁵ I.R.C. § 501(c)(3)

⁵⁶ I.R.S. Private Letter Ruling 9130002

⁵⁷ I.R.S. Private Letter Ruling 9130002

⁵⁸ I.R.S. General Counsel Memoranda 37789