

CITY OF LOS ANGELES
INTER-DEPARTMENTAL CORRESPONDENCE

Date: June 24, 2011

To: Councilmember Bernard C. Parks, Chair, Budget and Finance Committee

From: Gerry F. Miller, Chief Legislative Analyst *KEK for*
Miguel A. Santana, City Administrative Officer *RPC for*

Subject: **COMMUNITY DEVELOPMENT DEPARTMENT RELATED COSTS AND THE COMMUNITY DEVELOPMENT BLOCK GRANT**

SUMMARY

In December 2010, the Council and Mayor instructed the Community Development Department (CDD) to report to Council with an analysis of a proposed, additional 2010-11 revenue reduction for 2009-10 payments to the General Fund, and an assessment of CDD's General Fund obligation and corresponding General Fund contributions for indirect salary costs over the past five years (C.F. 10-0600-S51). The CDD responded in a transmittal dated January 5, 2011 (Transmittal) (C.F. 10-0600-S51).

The Transmittal includes a request from CDD to use unexpended Community Development Block Grant (CDBG) funds that were previously appropriated to CDD, but not expended, for payment of CDD salaries and associated related costs in Fiscal Year (FY) 2011-12. CDD also requests the addition of one Senior Management Analyst I exempt position authority and direction to expeditiously fill this position and other grant-funded vacancies in the Department in order to meet revenue projections for the General Fund from related costs and provide transfer opportunities to employees in general-funded positions.

When this item was considered by the Budget and Finance Committee (Committee) on May 23, 2011, the Committee instructed our offices to review CDD's Transmittal. Subsequent to the Budget and Finance Committee meeting, our offices met with the Department to discuss their request. At that time, CDD indicated that the funds they requested to use in FY 2011-12 were no longer available as a result of reprogramming approved by the Council when actions were taken regarding the Year-End Financial Status Report (C.F. 10-0600-S72)

and the 37th Program Year (PY) Consolidated Plan (C.F. 10-2440). Therefore, this request is no longer relevant.

Our offices do not recommend authorizing a new position at this time; however, on a going-forward basis we will work with the Department to develop a long-term plan for filling vacancies. This will require assistance from CDD to reconcile which positions, and what percentage of each full time equivalent (FTE), are funded with CDBG and other grant funds, and to which programs within the CDD these positions are assigned. The addition of a new position within CDD, and the filling of vacancies, will be considered as part of an overall review of existing CDD resources, vacant positions, and the feasibility of adding a position concurrent with the deletion of another; however, it should be noted that further reductions in the CDBG entitlement are expected for the 38th Year CDBG Budget.

In addition to the above requests, the issue of the application of the Cost Allocation Plan (CAP) rate was discussed in CDD's Transmittal. A number of policy issues were raised that require additional discussion before a policy recommendation can be made to the Committee. Our offices will report to the Council under separate cover on this issue.

Background

Departmental Request

The Transmittal from CDD includes a request from CDD to use unexpended Community Development Block Grant (CDBG) funds that were previously appropriated to CDD, but not expended, for payment of CDD salaries and associated related costs in Fiscal Year (FY) 2011-12. CDD also requests the addition of one Senior Management Analyst I exempt position authority and direction to expeditiously fill this position and other grant-funded vacancies in the Department in order to meet revenue projections for the General Fund from related costs and provide transfer opportunities to employees in general-funded positions.

As instructed by the Budget and Finance Committee, our offices met with the Department to discuss their request. As noted above, CDD indicated that the funds they requested to use in FY 2011-12 are no longer available; therefore, this request is no longer relevant. With regard to the positions, our offices do not recommend authorizing a new position at this time or filling existing vacancies; however, on a going-forward basis we will work with the Department to develop a long-term plan for filling vacancies.

Another issue that was raised in the Department's Transmittal and discussed in the meeting with CDD was the City's Cost Allocation Plan (CAP) rate and how it is applied. It was determined that this issue is a grant-wide issue, which impacts all CDBG-funded departments in the City (i.e., Aging, Building and Safety, City Attorney, Disability and Housing), and not just CDD. Further, any policy

adjustment relative to the CAP rate issue is not limited to the CDBG, but has larger implications to all grants throughout the City. The focus of the following discussion is solely on the application of the CAP rate to CDBG.

Cost Allocation Plan (CAP) Rate

The CAP rate is developed annually by the Controller from data supplied by the various cost centers in the City. It reflects the costs to the City for the fiscal year and is used to recover overhead costs (i.e., Fringe Benefits, Central Services and Department Administration and Support) for departmental grant programs. The CAP rate is used for all grant and special funds to ensure compliance with federal regulations regarding the City's Cost Allocation Plan. The rate is audited by the Controller and approved by the U.S. Department of Health and Human Services (HHS) under contract with the City's cognizant federal agency, the U.S. Department of Housing and Urban Development (HUD). The most recently approved CAP is CAP 32 for 2009-10, which was released by the Controller in October 2010. The Controller has developed interim CAP 33 rates for 2010-11 that have been submitted to HHS for approval. Generally speaking, the Budget uses the most recently approved CAP rate for purposes of budgeting and calculating the amount recovered from grants for related costs.

Application of the CAP Rate to the CDBG Budget

To the best of our knowledge, the CDBG Budget throughout the years has been prepared annually using the most recent adopted CAP rate available. This does not always align with the actual Fiscal Year represented in the CDBG Program Year being budgeted. In the absence of an approved CAP rate in a specific Fiscal Year/CDBG Program Year, past budgeting practice has held that the most recent adopted CAP rate is the one applied for budgeting purposes. The usual CDBG budget scenario historically involves the General Fund contributing more funding than it receives in reimbursements from CDBG. It may be useful to refer to this situation as an "underpayment" from CDBG to the General Fund. The reverse situation, where it is perceived that CDBG provides "overpayment" to the General Fund is part of the concern discussed by CDD in the Transmittal. Such an overpayment situation is unusual relative to a specific department's related costs, and to our knowledge, has not offset the grant-wide reimbursements from the General Fund for a given Program Year. Further, policy decisions over the last several years have resulted in contributing increased funds toward CDBG programs as opposed to maximizing General Fund contributions. As a result, the General Fund has contributed a portion of the resulting unrecovered related costs. It should be noted that affirmative steps have been taken by the Mayor and Council to reduce the overall amount of General Fund contribution to the CDBG grant.

A situation where the General Fund is overpaid would occur when the budgeted CAP is higher than the CAP used for billing (or corresponding FY CAP). For example, the City budgeted using CAP 32 in PY 37 (2011-12) and determined that \$1.5 million was owed to the General Fund for a department's related costs

reimbursements and CAP 33, which is lower, is subsequently released during the Program Year. In this hypothetical example, with a lower CAP rate the department's related costs are only \$1 million. Using the principle applied above, because the actual related costs based on CAP 33 are less than what was budgeted using CAP 32, there could potentially be \$500,000 available for reprogramming.

A situation where the General Fund would be underpaid would occur when funds are "owed" to the General Fund. For example, if the adopted PY 37 (2011-12) Consolidated Plan budget used CAP 32 and provided \$1 million for related costs to a department, and CAP 33 is released during the Program Year, and based on that CAP rate, the related costs are \$1.5 million, the General Fund is "owed" \$500,000 for related costs.

Application of the CAP Rate to CDD

CDD proposed to use CAP 32 to transfer 2010-11 General Fund reimbursements, rather than the CAP 31-level reimbursements used to budget for PY 36 (2010-11). At that time, CAP 32 was the interim CAP rate as it was not approved by the Federal Government until September 2010 and distributed by the Controller until October 2010. The CAO initially advised CDD to continue to reimburse the General Fund at the originally-budgeted CAP rate, in compliance with the City's past practice relative to CDBG budgeting, and to avoid a negative impact on General Fund revenues. Reimbursements to the General Fund for 2009-10 were processed based on the CAP 31 rate for 2008-09. As noted above, the CAP rate for 2009-10 costs (CAP 32) was subsequently released in October 2010. The CAP 32 rate (39.59 percent) for CDD is approximately 17 percent less than the CAP 31 rate (56.41 percent).

CDD subsequently proposed to reduce 2010-11 revenue to make adjustments for the reduction in the CAP rate for 2010-11 costs and to further reduce General Fund revenue by \$2.7 million to offset the 2009-10 General Fund reimbursements. The Financial Status Report included instructions for CDD to report to Council within 30 days with an analysis of the proposed 2010-11 revenue reduction and an assessment of CDD's General Fund obligation and corresponding contribution for unrecovered indirect salary costs over the past five years (C.F. 10-0600-S51). The Transmittal included information regarding CDD's General Fund reimbursements of related costs for the period from 2000-01 through 2009-10 (actual versus obligations based on the approved CAP rate). It should be noted that the reimbursements may be less than the originally-budgeted amounts.

The question raised by discussion of CAP rates relative to CDBG is related less to budgeting and more to actual billing, which is impacted not only by the CAP rate used in a given Program Year, but also by the number of staff charging direct and indirect salary costs to CDBG. Further, when there are more funds budgeted for related costs using a given CAP rate than required, savings are generated within the related costs account. Past practice has held that savings

in any program, whether program, salaries or indirect costs, are discussed during reprogramming reviews relative to a midyear review or in preparation for the following year's PY. Savings have typically been returned to the CDBG budget pool and effectively reprogrammed for general, not specific, purposes. Our offices have discussed indirect cost charging methods with Los Angeles County to determine whether the City's process is similar; however, the use of general funds in the County budget appears to be limited to matching funds and is not used for indirect cost reimbursement.

In the meeting held with our offices and CDD to discuss the Department's Transmittal, CDD provided information on HUD regulations which allow for the reconciliation of underpayment of administrative costs only within a 90-day window after the close of the Program Year. There was no specific discussion of a HUD regulation or potential City guidelines relative to overpayment compensation for the General Fund.

Current practice allows for any related cost overpayments or underpayments to be corrected from year-to-year because the CAP rate is adjusted annually by the Controller. In the CAO's report on the Cost Allocation Plan (CAP) Rate Study and Grants (C.F. 08-2623), it is noted that:

The City's indirect cost rates are known as "Fixed With Carry Forward" rates because the Federal Government approves a permanent ("fixed") set of rates for each fiscal year that the City can use in preparing final billings for that year. The federal grantors can be comfortable with rates that are based on cost estimates (i.e., based on costs from a previous year) because the Carry Forward Adjustment portion of the rates is the mechanism that allows for actual costs to eventually "catch up." Because most grant programs involve multi-year relationships between the City and the grantor, the use of these Fixed With Carry Forward rates ensures that the City and the grantor are "made whole" over time (i.e., indirect cost under-charges and over-charges are eventually resolved through the use of the Fixed With Carry Forward rates).

To our knowledge, a reconciliation of prior year General Fund reimbursements for related costs incurred by CDD based on the change in the CAP rate has not been implemented by CDD in the past during the budget or reprogramming processes associated with CDBG. A number of policy issues were raised during the discussion relative to adjusting the application of the CAP rate, such as the feasibility of an annual reconciliation and compliance with HUD regulations, and how the CAP rate is applied to other CDBG-funded departments that have historically not reimbursed the General Fund for related costs because of previous policy decisions.

It is recommended that the City's current practice of seeking General Fund reimbursement based on originally-budgeted amounts be continued and that discussions relative to billing actual versus budgeted CAP rates be held with

CDD, CAO, CLA, the Mayor's Office and CDBG-funded departments to ensure consistency across user departments, priorities relative to any savings identified or monies owed the General Fund, a plan to reconcile the related costs for CDBG-funded departments as part of the closeout of each CDBG Program Year, and compliance with any applicable HUD regulations. Any best practices emerging from those discussions will be included in the CLA/CAO report with recommendations relative to the 38th Program Year CDBG Budget.

RECOMMENDATIONS

That the Council:

1. Continue the practice of budgeting the Community Development Block Grant Budget (CDBG) using the most recent adopted Cost Allocation Plan (CAP) available;
2. Instruct the Community Development Department (CDD) to submit to the City Administrative Officer (CAO) a long-term hiring plan for Fiscal Years 2011-12 and 2012-13, which takes into consideration all positions; funding sources; vacancies; other potential staffing changes; and the elimination of all General Fund support and the balance between program costs and personnel costs pursuant to C.F. 11-0600. This hiring plan may be considered when positions are presented to the Managed Hiring Committee on a case-by-case basis; and,
3. Continue the discussion regarding budgeting, billing and application of CAP rates relative to CDBG with the CDD, CAO, the Chief Legislative Analyst (CLA) and the Mayor's Office to ensure consistency across departments and compliance with any applicable HUD regulations. Further, instruct the CLA and CAO to include any best practices emerging from that discussion in their joint report with recommendations relative to the 38th Program Year CDBG Budget.

FISCAL IMPACT STATEMENT

There is no General Fund impact associated with the recommendations in this report at this time. Proposed changes from current practice relative to General Fund reimbursements of related costs from CDBG may impact future years of the Community Development Block Grant Budget.