

Forgiveness of Penalties from Illegally Authorized Payments

November 3, 1988

Honorable Jack Davis
House of Representatives
Washington, DC 20515

Dear Mr. Davis:

This is in response to your letter of October 6, 1988, concerning the City of Aurora, Illinois' Community Development Block Grant (CDBG) program. You asked, on behalf of Mayor David Pierce, whether penalties resulting from illegally authorized payments in the City's CDBG program could be forgiven.

We understand from the Mayor's enclosed letter and from speaking to HUD's Chicago Office staff that the City has been advised to reimburse its CDBG program account from non-Federal funds in the amount of \$230,000. This amount represents the payments made by a city employee to a contractor for CDBG-funded rehabilitation work never undertaken.

The City feels that for several reasons the penalty should be forgiven. First, improvements made to the CDBG-funded rehabilitation program will prevent any further occurrences of illegal payments. Second, it uncovered the illegality and has been cooperating fully with HUD. Third, although the litigation is currently inactive, the City continues to seek criminal prosecution and restitution of the CDBG funds. Fourth, the City also feels that low income persons -- the intended beneficiaries of the rehabilitation program -- will be penalized a second time if the City pays the penalty.

We appreciate the full cooperation of the City and the efforts to ensure that the CDBG-funded rehabilitation program operates effectively and that the funds are recovered. The City acted promptly and responsively to establish internal controls.

The City is incorrect in thinking that reimbursing its CDBG account from non-Federal funds will harm low income persons a second time. In fact, the reimbursement replaces the misused funds. It will provide the funds, if the City chooses to use them for that purpose, for rehabilitation of homes for low and moderate income persons. Without the reimbursement, there would be a loss of funds to the CDDG program.

Based on the information furnished to us, we understand that the City was unprotected against the initial loss, due to lack of insurance. The City could have charged the costs of insurance or contributions to a reserve for self-insurance as an allowable expense to the CDBG program. However, OMB Circular A-87 specifies that actual losses which could have been covered by permissible insurance are unallowable costs and, thus, the Chicago Office is advising the City of Aurora to reimburse its CDBG program in the amount of the unallowable costs.

We are in agreement with the determination of the Chicago Office. Their actions are consistent with our policies in similar situations. To avoid undue hardship on the City, it is acceptable for the City to reimburse the Letter of Credit at the rate of \$115,000 each year for two years. The Chicago Office is writing to the City to provide specific advice on this matter.

Very sincerely yours,

Timothy L. Coyle
Assistant Secretary