Final Transcript

HUD-US DEPT OF HOUSING & URBAN DEVELOPMENT: How to Read Financial Statements - Intermediaries

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SPEAKERS

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PRESENTATION

Moderator — Ladies and gentlemen, thank you for standing by. Welcome to the How to Read Financial Statements conference call. At this time, all participants are in a listen-only mode. [Operator instructions]. As a reminder, this conference is being recorded.

I'd now like to turn the conference over to Robin Booth. Please go ahead.

Robin — Good afternoon, and welcome to How to Read Financial Statements sponsored by the Office of Housing Counseling for the Comprehensive

Housing Counseling Grant. Today's participants are primarily intermediaries, because this particular topic impacts you all directly.

Just some logistics. As you know, this is being recorded. The playback information, including the training materials and the audio, will be available on HUD Exchange, usually in two business days. You will get an update or an email from the training digest indicating that this new webinar is posted, so you can look for that to let you know when the audio transcript and the training materials are posted.

If you registered for this training you actually have a copy of the training materials in your control panel as a PDF file. So, if you just click on that document in your control pane, you can download it, and those are the same training materials we'll be reviewing today and that will ultimately be posted to HUD Exchange.

Due to the size of this particular training session, it's a pretty small training session, we may have a Q&A period throughout the presentation. I may ask if there are any questions. I do monitor questions that are being submitted through the control panel, but if there are questions that you would like to ask, you can ask them live. We ask that you please hit star zero, and you will be placed in the queue. At various points throughout the presentation I'll ask the moderator if there are any questions in the queue, and you can ask your question live and we'll attempt to respond.

If you would prefer not to ask your question live, you can submit a question through your control panel, and for the webinar we do have staff available to answer those questions. They will be answering them real-time, so if you'd rather just submit a question through the control panel, that's fine.

Intermittently, when I ask if there are any questions, if there are questions that were answered through the control panel that I believe may benefit the entire group, I may go ahead and read those questions and then respond live during the call. If after this presentation you realize you have additional questions, you can always submit them to housing.counseling@hud.gov. We ask that you put the subject matter in the line item to make it easier for distribution.

Please note that if you are not a stakeholder of the Office of Housing Counseling, specifically the Comprehensive Housing Counseling Grant Program, we will not be able to respond to your questions. So, we welcome participants from different grant areas and different grant programs and areas throughout HUD. However, we will only be responding to questions submitted by stakeholders for the Comprehensive Housing Counseling Grant.

All the lines have been muted, but during the live call we will be unmuting lines for those individuals that have called in or that have indicated they would like to ask a live question. But your lines will remain muted.

After the training, if you registered and logged in, you will receive a thank you for attending. That email itself is the certificate. There is no attachment, so please maintain a copy of the email, either download it, save it or print it and keep it for your records. There will not be any other attachment or a subsequent email sending you a certificate. That will serve as your certificate.

You can also get credit the same way. You go to HUD Exchange, and then you look for this date and topic, and then you can select the credit to get credit for that training.

My name is Robin Booth. I am the Audit Principal for Booth Management Consulting. Our company is the contractor providing quality audit, technical assistance, training, and financial analysis services to the Office of Housing Counseling. Many of you may interact with us through one of those areas of services, including financial and administrative reviews, things such as reviewing grant execution packages, these trainings, both through webinar and individual one-on-one training, action plans, and other assistance provided by OHC.

So, today's topic is really just to help you, and I think it's timely because a lot of you are probably going through some phase of your grant execution package with your sub-awardees, so what we're trying to do is to give you some insight as to how to read those financial statements. The reason the financial statements are required for submission is because as a federal awardee and a pass-through entity for the federal government you're responsible for ensuring that these agencies, or these sub-award recipients that you're providing these sub-award grants, that they have the financial capability to perform.

One of the easiest ways and probably less intrusive ways to verify or to at least be able to document that you did your due diligence in determining whether they had the financial capability to perform is to review their financial statements. So, not trying to require you to have extensive accounting or auditing experience to be able to do an in-depth analysis of their financial statements, but there are some basic things that you need to understand about these statements and to be able to read them to make some general assertions as to whether there appears to be something that could impact their ability to perform on the grant.

Now, after we get through this training presentation and you start to think about some of your sub-awards and once they've submitted financial statements and you realize, hey, they may have some of the deficiencies or some of the things that trigger a potential for not being able to perform, you may want to consult with your internal finance or accounting, or you can actually ask for assistance through OHC for us to do a more in-depth review of their financial statements, just to make sure that you can clearly document through your files that you've done your due diligence as it relates to really protecting the grant award that's awarded to the sub-recipients.

So, with that said, our topics today are meant to be broad and general. This is to give you I guess a point of reference and some triggers and some things to look for that may indicate that there are some issues relative to their ability to perform, and if there are, then maybe you need help or you need to get additional assistance to have further analysis done to make sure. I mean you're a fiduciary of these funds when they're awarded to sub-recipients, so the burden is on you to make sure that you've at least documented and done your due diligence to make sure you're making a good award.

So, we're going to go over the different levels of financial reporting because there are different levels and some of the key financial reports. When we say financial statements, it's not just one statement. It's a collection of statements that represent a full financial statement.

The types of audit opinions under this grant, everyone is supposed to submit audited financial statements. Although, we recognize sometimes there are exception, the general rule is that you should be looking at audited financial statements, to go over single audit requirements or OMB A-133 audit requirements for federal awards that exceed $750,000 of costs incurred or claimed or invoiced during a given period, and then to let you know what services you have available to assist you if in fact you realize you need some help in understanding or deciphering some of these financial statements, so once again you can be assured that you've done your due diligence relative to their financial capability to perform.

Levels of financial reporting. For this grant you always hear about audited financial statements, and actually the audited financial statement is the highest level of reporting because it's actually a report by an independent certified public accountant to the stakeholders, whether it's to external users and internal users, that they have done sufficient due diligence, testing, planning, and all of those things to ensure that these financial statements are not just consistent with generally accepted accounting principles, which is the foundation and base for all financial statements, but that in their opinion in the best case scenario that there's no deviations and that these financial statements are presented fairly and accurately.

So, that's why under the grant they require audited financial statements, but I will be honest with you, they are the most expensive. That's because of the level of work required by these independent accountants to be able to provide that opinion. So there's a lot more testing, there's a lot more in-depth analysis, there's a lot more time involved because they're not just looking at the transactions from a high level, they're actually digging down and really going into the details of the financial statements.

The next level, the next lower level, because, remember, the audit is the highest level, so that's why it's required. Now, some agencies may not have audited financial statements, and that's because there's a cost. There's usually a material cost to get audited financial statements because you have to hire a CPA and the hours that it takes to perform the procedures for them to be able to issue an opinion.

So, sometimes agencies will give you reviewed financial statements, and for all of these financial statements, when we go through the actual accountant's reports that are included, you'll see that in the first paragraph of that report it's going to tell you whether the financial statements were audited, whether they were reviewed or whether they were compiled. So, the second level, which is a lower level than an audit but higher than a compilation, under both circumstances, and once again, that's an independent certified public accountant that has to complete that review of the financial statements, they're doing limited procedures.

So, unlike under the audit where they're actually going to go in and test transactions and look at sourced documents and really go from the transaction to whether it's a receipt or a timesheet or down to the original sourced documents, under a review they're looking at it from an analytical perspective. They're going to review accounts to make sure there doesn't appear to be any accounts that do not appear to be consistent with generally accepted accounting principles.

They're going to do comparisons from this year to prior years. They're going to look at account activity, but what they're not going to do is they're not going to actually test those transactions. They're not going to go to make sure that if you said this was $5 that you were billing to this grant that you have the supporting documentation for that $5 and that you've properly reported it in your financial statement.

So, this review is less expensive than an audit because as we said, they're not doing any real testing, so all of the hours involved in that kind of testing are no longer applicable. But it's actually more expensive than the next lowest level, which is a compilation.

Now, a compilation does not have to be issued by a certified public accountant. Actually, sometimes that report is issued by people internal, the internal accounting department, because all that report is telling you is that, hey, they gave us some financial statements generated from their system. Management is representing that this information is correct. All we’re doing is looking at it to make sure that it’s in proper format consistent with generally accepted accounting principles, so, for instance, that certain accounts are on the right reports.

But we’re not doing any analytical procedures. We’re not doing any testing. We’re not looking at internal controls. We’re totally relying on what the management of that company or agency has given us, and we’re just really making sure that the format of it and that how it’s being reported is consistent with generally accepted accounting principles.

We’re not doing any in-depth analysis or testing or anything. So as you can see, that report is the least level of assurance, because even if a CPA does issue it, they’re telling you that, hey, I don’t know if any of these numbers are right. I know that they’re on the right reports and they’re organized right, but I can’t tell you if we look at the actual testing or the actual transactions if those transactions are being reported correctly.

That is the least expensive, though, and a lot of times you may see, especially your smaller sub-awardees, they may give you compiled financial statements. One of the things that we’ve seen as we’ve gone through a lot of the grant execution packages and reviewed a lot of financial statements is that in those instances they have sometimes generated internally these compilations, and just by looking at the reports we identified deficiencies or exceptions from generally accepted accounting principles, which of course raises our concerns, because if the report isn't in the right format just from content, we have real concerns about whether these numbers are actually correct.

So, with an audit, we can rely more on that audit. We have more comfort with that audit. But when you get to the compilation, you really have to look at, if you don't have an accounting or financial background, you really may need somebody else to look at those compiled financial statements just to even make sure they're being reported consistent with generally accepted accounting principles.

That's where you can ask for either assistance through OHC, where they would have us review them and let you know if we became aware of anything, or internally, if you have resources that have time to review them, you could have them. But as the level of reporting decreases from an audit to a review to a compilation, the burden on you to make sure you're understanding what you're reading increases because you have less assurances as the reporting levels decrease. So, a financial statement audit is required by HUD. Some of the smaller LHCAs, they submit reviewed or compiled financial statements, as we just said.

Now, all of the HFSAs and MSOs, they all submit audited financial statements, so the good thing is if you have an audited financial statement, then you're really not as concerned with making sure that the numbers are right or presented correctly. You're really more concerned with reading the report to make sure that it's telling you it's a clean audit, meaning they didn't become aware of anything that was an exception, and reviewing the disclosures, the notes at the end of the report, to make sure there isn't anything in there that may impact the agency's ability to continue in business. So, it's a higher level of assurance you can rely more on an audit than you can the other types of financial statements.

Now, a single audit, as I said, and this is required for agencies who receive $750,000 or more of federal awards during a fiscal year. So, it recognizes not whether they were awarded the money, but if they actually spent or invoiced up to $750,000 for a major program. So, it's not the cumulative amount of their federal awards, but if they received a federal award for $750,000 or more and they've invoiced or billed for that amount.

So, sometimes, let's say someone has an award and they were awarded it at the end of their fiscal year, so they really never billed against it, well, they wouldn't be required to have a single audit done yet because they haven't billed or incurred any costs on it yet, it would be in the next year. The award itself isn't what determines if they met the $750,000 threshold. It's actually what costs they've claimed and invoiced during that fiscal period.

Some of the key financial statements, and unfortunately, especially when you're looking at compiled and reviewed financial statements for some of these sub-awards, and this is based on our experience, a lot of them don't even use the correct names for financial statements for not-for-profit organizations. So, what you'll see, and with compilations when they are generating it internally, they may be printing a report out of their accounting system, and their accounting system still uses names for financial statements that are more indicative of for-profits. But because they're a non-profit using a for-profit accounting system, they're not calling them the proper financial statement names for a non-profit.

So, what I hope to do here is to kind of give you a crosswalk, so you'll know that, okay, sometimes, let's say with audited financial statements, I see a statement called statement of financial position. But let's say I have a compiled financial statement from a sub-award because they didn't have an audit, and they call it a balance sheet, so what this crosswalk helps you to do is to give you a crosswalk that those reports are synonymous. It's just that it's different names for the reports based on whether it's a for-profit or a non-profit.

So, non-profit, when you have a statement of financial position, you'll see that especially on audit, that's equivalent to a balance sheet if you get a compiled or reviewed financial statement and they're calling it a balance sheet. Those are the same statements. It's just the correct name for a non-profit is actually statement of financial position, and the name that you'll see used sometimes instead of that is balance sheet.

What that is, I always say the balance sheet is looking at the cumulative effect of really the business over time, so this is not based on fiscal year to fiscal year. This is the cumulative effect. So, one of the accounts, for instance, that's on a balance sheet is cash, you'll always see cash. So if you think about your own bank account, cash is always cumulative.

Your balance always rolls forward from one month to the next month. Your ending balance one month is your beginning balance the next month, and it's carrying forward. So, even on financial statements for these agencies, that cash is cumulative from the beginning of time. That's what a balance sheet is, it's looking at those accounts that are cumulative from the beginning of the organization, so things like cash or if they have things like receivables because maybe you bill your agencies and you're waiting to get paid, and you haven't gotten paid yet. That's treated as a receivable.

Well, you could have some receivables that go back for a year. Hopefully, not, but that could happen. So, on that statement of financial position, that receivable is going to stay there until it's paid, and that's what we call those cumulative accounts. Those are the kind of accounts on your balance sheet, cash, accounts receivables, accounts payables, if you have loans and the net change.

Really, the net change in the net assets, that's the cumulative assets of the agency since the time it started. So, each year if sometimes their revenue exceeds their expenses, in a for-profit we call that net profit, but in non-profit, we call that an increase in net assets. So, pretty much when you look at the balance sheet, it's telling you that since the beginning of the time, sometimes they have increases in net assets, sometimes they have decreases in net assets, but as of this date, whatever that date is on that statement in our financial position, these are the actual net assets that they have cumulatively.

Now, when we get to the next statement, that statement, the statement of activity, which is also referred to as a profit and loss statement or an income statement on a for-profit side, that is looking at fiscal year to fiscal year, because that's looking at the monies you have coming in and the monies you have going out.

So, unlike the balance sheet which is cumulative, that statement of activity and/or income statement is in fact based on each fiscal year, and that's how you're reporting monies you've received and monies you've spent, or revenue you've received or earned or support and monies that you've spent on a bi-fiscal year. So, that's the big difference between a balance sheet or a statement of financial position and a statement of activity.

Those are the two statements; the statement of financial position and the statement of activities are primarily the statements you're most concerned with, especially that statement of activities, because you're looking to see for the most recent fiscal year that they're reporting whether they had more revenue or support for the program than they had expenses. If they had more expenses than revenue, they're not showing that, and at least for that fiscal year they may have been operating at a loss, at a deficit.

However, let's stay this is a 100-year-old agency, so over time they've accumulated a lot of assets. When you look at that balance sheet, even though that organization may not have had a good year that year, the balance sheet, because it's cumulative, still could be a really good statement of financial position. It still could be a really good statement. It's just that they had to use some of the assets that they had accumulated over time to cover them for that year. And that's why those two statements, the statement of financial position and the statement of activity, are the two most critical statements that you should look at.

Things like the statement of cash flows, the statement of cash flows is really an accountant's report, and I'll tell you, a lot of times a lot of accountants don't even understand it. That's purely looking at cash. And not to become too techy, but it's kind of saying that this is the cash you had at the beginning of your fiscal year, this is how you spent your cash in summary over the year, and now this is how we come to this cash balance at the end of the year.

Banks, financing institutions, lending, they care about a statement of cash flows because it shows cash coming in and going out. For your purposes, generally, because those statements aren't as easy as I just made them sound, they're not that easy to understand because how they're organized and how they're developed, but that statement, all it does is pretty much tells you how they got to their ending cash balance.

Now, unlike the statement of functional expenses for a non-profit, there really is no equivalent statement for for-profits, but because on a for-profit they're going to show you their expenses actually on the statement, so on a profit and loss statement for for-profit, you'll actually see the expenses. What non-profits are required to do is even though they have the statement of activity where they show you the revenue coming in and expenses, they're showing you the revenues and expenses by program areas and whether it was administrative and whether it was temporarily restricted and unrestricted.

So, when you get to this statement of functional expenses, they are then breaking out those summaries that were on a statement of activity and saying, okay, this is our program areas, and sometimes, they'll break it out to be by funding bucket and they'll show you the expenses by funding bucket or sometimes they just call them program areas. And then they'll show you the expenses for administrative, the detail because on the statement of activity it actually just summarizes everything.

So, there are your key financial statements, and as I said, you really pay the most attention to the statement of financial position and statement of activities. All of these things I kind of just discussed, but just to reiterate, on that statement of financial position, it's going to have total assets, total liabilities, and net assets.

Then for net assets, and this is strictly a non-profit accounting requirement, you have to break the assets into three different buckets. Unrestricted is when there's no restrictions on how you use the funds. Usually, that's coming from contributions and donations or just maybe you have a funding source that says we don't care how you use it, whatever you deem is necessary.

Temporarily restricted is where your actual federal awards fall into because they have temporary restrictions [indiscernible] budget because it says that you have to use these federal dollars based on this approved budget. That's a temporary restriction. So, once you actually use it for the purpose it's designed, then those monies become yours as unrestricted.

Permanently restricted are assets that have to stay intact, and you can use the interest from them, like endowments, or fellowships, or things like that. That's indicative of any agency, whether they have those types of permanently restricted, but your federal awards fall in the temporarily restricted category.

So, when you're looking at this one, one of the things you want to do is you want to look at your ratio of current assets to current liabilities. Now, if you're looking at financial statements that are prepared correctly, they're going to separate current assets from long-term assets and current liabilities from long-term liabilities. So, you would literally take the current assets and divide it by the current liabilities.

Now, the goal is for your current assets to exceed your current liabilities by at least double. So, if their current assets are $200,000 and their current liabilities are $100,000, there's a 2 to 1 ratio. That's a pretty good ratio. But let's say their current assets are $100,000 and their current liabilities are $200,000, that's evidently a negative ratio, because your current assets are things like cash and your receivables, so that's the resources you have available to meet your operating needs.

If your current liabilities, which are like your payables and things like that, if you owe more out than you anticipate to receive, then that's evidently a problem. So, even if you didn't run a ratio but you just looked at the numbers, you looked at your total current assets and compared them to your total liabilities, and especially if you notice that your current liabilities are greater than your current assets, you need to get an explanation from them, well, what's your plan here, because it doesn't look like you have enough in your coffers to pay your current liabilities. So is there some additional funding you're expecting? Please explain to us what your plan is for ensuring that you can meet your current obligations when they become due.

Another factor is an accounting factor, and I keep trying to make it so that I'm not being too techy. But when you have long-term debt in your financial statements, they have to show the payments that will be due in the next 12 months as short term, and then the rest of the debt stays in as long term. So, let's say it's on a building or a mortgage, and the mortgage itself outstanding is $1 million, but you pay $10,000 a month, on the financial statements, those $10,000 payments, that $120,000 will be a part of your current assets because that's what's due within the next 12 months. The balance, which is $880,000 that will still show in your long-term.

So, under that scenario, you should pay attention to if they had on their financial statement what their portion of their long-term debt is. Now, it will be included in your current assets anyway, so you'll pick it up. But that's just something else you should look at.

Statement of activities, net loss is not always a bad thing. Sometimes on a statement of activities, and as I said, remember, statement of activities is revenue minus expenses. So, I gave you the scenario where an agency, maybe they lost one of their major funding sources in this fiscal year, so they had to rely on their reserves from other years and that's their net asset that they've accumulated, so when you look at their revenues or support minus their expenses for this year, there's a loss.

But let's say some of that loss may be what we call a non-cash transaction like depreciation, so depreciation actually is you writing off or depreciating what we call long-term assets. So, for a building, for instance, and I just gave you an example, a building, usually you have a mortgage or you have some kind of payment, so you're not paying the total amount of that building in one operating year. The way that you recognize your payments for mortgages is through depreciation expense and interest expense, so depreciation really isn't an actual cash amount that you pay. It's just recognizing the depreciation of the value of that building over time, and you get to deduct it as an expense. So, that's a non-cash transaction.

So, when you see something like depreciation or amortization, or if there's a write-off of any kind, what we do from an accounting perspective, if we were looking at financial statements we would add that back to whatever those total expenses are and say, okay, that's really not cash. So, although their expenses were X, let's deduct that and say this is the real expenses that they had to pay. Sometimes, that'll result in there not being a net loss for that agency.

You want to look at large fluctuations. On your financial statements, they're always supposed to report two-year financial statements. So, when you get an audited financial statement, unless it's a new agency, they're always going to show you two years. They're supposed to do it with reviews and compilations, but compilations, you may not see two years on one statement. So, you may need to ask them for the financial statements for the prior year, but on an audited financial statement, they're always going to show you two years.

So, what you want to look at, especially on the statements of activities is the fluctuation of revenue or support in expenses. Let's say you notice that, uh-oh, it looks like they lost a lot of support or their revenue or support decreased substantially from last year to this year. Okay, what does that mean? Did you lose a funding source? How do you plan to recover from that? Especially if you don't see a corresponding decrease in expenses, and usually, what you'll see is that that'll result in a net loss.

So, if an agency's revenue is going down, but they haven't addressed their expenses, so their expenses are staying the same, even if it's not a net loss yet, you should question what their plan is. Are you planning to cut expenses so this doesn't become an ongoing issue where you may not be able to meet your obligations in future periods because you kept your expenses the same even though your support isn't there? So, it's a matter of asking questions.

On the statement of financial position, if you see a large fluctuation, especially in debt, if you see their liabilities increase substantially and because of that large increase in liabilities they're not as financially strong, you may ask the question what happened, especially if you see liabilities related like taxes or anything like that, payroll taxes would be, understanding that they wouldn't have income taxes. You would ask questions about those large fluctuations.

And what you're trying to do is if there are concerns, you're asking them to explain them to you and explain how they're going to be addressed so that even if you move forward with the decision to award them a grant, that you can at least document your file that you did your due diligence to get an understanding of what potential issues there were. And then you're able to refer back to that file in subsequent years if in fact they come back around for another sub-grant and you realize, okay, have you even addressed the issues from the prior financials. Because if you're continuing the same behavior, then I might have to make a different decision this year when it comes to the award.

So, your job is to document your file and then to give some reasonable assurance that they have the financial capability, and they have a plan if their financial situation has changed for the negative. And then you also want to take into accounting leveraging of funds from non-government resources, so if they get a lot of unrestricted contributions and things like that, that's a positive for them.

If their sole source of funding is a federal award, especially if it's this award and you notice that they don't have a lot of reserve, so when you look at their statement of financial position they didn't have a lot of cash there, and their total funding is coming from this one source, you may talk to them about, okay, your leverage funding you're supposed to have in place. What happens if there's a delay in receiving this funding? Will you be able to continue your services? Those are the kind of questions you ask if you see that occurring.

Now, the statement of cash flow, operating, and investing, as I've told you, the statement of cash flow tells you how you spent your cash, but the way that they're required to report it for generally accepted accounting principles is they break it into three groups, either from operating this was how your cash was spent, from investing or from financing. So, it requires a little bit more of an accounting background because certain types of activities fall within these categories, but all you're really looking for there is to make sure that whatever the ending cash balance is on that statement is the same cash balance that's on the statement of financial position, not a lot of information unless you're having an accountant that does a more in-depth review of the financial statement.

For the functional expenses, you want to be concerned about ratios of program, administrative, and fundraising to total. You know, you don't want to see where administrative is 30% of the total expenses. That's too high. And that would raise an issue about why are there so many expenses associated with administrative and how does that affect the overall delivery of the services that they're performing as a non-profit.

And then we just put in here, for instance, United Way uses a benchmark that at least 75% of your total expenses have to be for program. So, HUD doesn't have a similar benchmark established, but if in fact you see 30%, you may want to ask them, why are there so many costs going to administrative and not program? What is your plan? How does that impact your ability to provide services? And get some indication of what their plan is to kind of get that more in line. That's really consistent too with the FY18 grant, where there's such a focus on eligible activities and then costs associated with eligible activities.

The other part of those financial statements becomes your financial statement disclosures, and these are called notes to financial statements. That's the narrative at the end. So, after you get through the accountant's report and then you get through your statement of financial position, your statement of activities, your statement of cash flow, and then your statement of functional expenses, then you get your note. These notes really are supposed to help explain the financial statements to stakeholders and understanding that without these explanations a lot of the numbers just wouldn't make sense. You wouldn't have an understanding.

Under generally accepted accounting principles, certain financial statement disclosures are required, and that'll be what they call the summary of significant accounting disclosures and accounting activities. They're required. It's required to tell you what kind of company it is and how it recognizes cash and what basis of accounting, whether it's cash or accrual. Those are required disclosures.

Now, you will not necessarily see them with reviewed financial statements, they won't have disclosures, and compilations won't either. So, audited financial statements are required to have disclosures to help explain a financial statement. If the reviewed financial statements are done by, I would say, an independent accountant, those financial statements have disclosures.

Compilations almost never have financial disclosures, and as I said, that's why there's the least level of reliability on those statements, because not only are those compiled financial statements just coming from management, but then you don't even have any explanations or additional disclosures for you to understand them. That's why they may require a higher level of scrutiny.

Now, for you, you want to look for certain disclosures that aren't required, but generally may alert you to some challenges or some potential challenges for financial difficulties. So, certain disclosures, like you want to read like your debt disclosure, if they had a lot of debt, and you always want to be concerned with that, understanding that these are smaller sub-awards, so these award amounts aren't a lot, but if they have a lot of debt, that's usually a sign that they're not able to meet their financial obligations as they become due.

So, sometimes agencies get in more debt as their revenue or support decreases and they're trying to establish other ways to fund their operations, so you want to read any disclosures relative to debt. You want to read any disclosures relative to commitments and consent issues, because that will include, for instance, some contingent liability may be liabilities where somebody signed off or signed for something, or they guaranteed certain obligations, or they have other commitments that you don't have to report in a financial statement based on generally accepted accounting principles, but if something happens to that third party, they then become obligated. So, you want to know about what we call off the books or off the record kind of commitments and contingencies.

Separate legal footnote. Lawsuits, anything relative to potentially legal actions that could impact their financial situation, those things, they're required to be disclosed in a separate legal footnote.

Subsequent events. Almost all financial statements say subsequent events, and what that is is from an audit perspective if we're auditing financial statements, we're required to disclose any financial activity that we become aware of after we've completed our field work to do that audit.

So, sometimes a subsequent event note will just say we did not become aware of anything that would impact these financials. Other times that subsequent event might say, well, after we finished our field work, they lost one of their largest funding sources. So now, even though it didn't impact the year you're looking at, we're telling you that it is what's happening because it will have a potential impact on future financials. We became aware of it, so we have to disclose it. We, being the auditors, became aware of it.

So, I've talked about the audit a lot because that's what's required under this grant, and there are different types of audit opinions. The auditor, when they complete their report, I always say the only thing that we own is that actual audit report, where we're telling you as a stakeholder and we're telling the general public and third parties based on our audit procedures performed consistent with generally accepted accounting principles, generally accepted government auditing standards, if applicable, we're telling you that these financial statements are either unqualified/unmodified meaning their clean. In this instance, any unmodified/unqualified meaning there's a clean report. We did not become aware of any deviations or any deviations from generally accepted accounting principles that impacted these financials, that what you're looking at is pretty true and accurate.

Now, if we become aware of certain circumstances, or that there's some exceptions from generally accepted accounting principles, or we weren't able to get sufficient documentation to perform certain audit procedures, or it could be that people weren't available or didn't provide the information, then in our report we will say that we were not able to obtain that level of assurance. We'll tell you what those areas are that are an issue, and that's called a modified.

And we'll go over the reports. The language is really clear, and it doesn't deviate too much because as auditors we're required to use certain language. So, a modified report is telling you, hey, they might hve been 80% consistent and compliant, but this other 20% you need to know about these limitations that impact your ability to rely on these financial statements.

A disclaimer is basically saying we can't audit this report because we don't have sufficient information to audit these financial statements, and that's telling you that evidently the agency didn't provide the information or had the wherewithal to meet the level of scrutiny required to go through an audit. An adverse opinion is when we do actually perform the audit procedures, and we're telling you that none of these is consistent with generally accepted accounting principles. Pretty much, we're telling you that this report is not accurate and complete and consistent with generally accepted, and that's the worst opinion that you could possibly have.

So, in an unmodified or unqualified, that's the best report, an unqualified one, we're basically saying that the company's financial records and statements are fairly and appropriately presented. This is the most common. That's the report you want.

Now, look at this report, and this report doesn't change. In that first paragraph, remember I told you we tell you what type of report this is, so, we'll tell you, here it says we have audited. If it was a reviewed financial statement, it will say we have reviewed. If it was compiled, it would say we have compiled.

In the third paragraph, there will always be an opinion paragraph, and I've underlined that opinion paragraph. Now, sometimes, especially if it's a modified report, that opinion paragraph may be later on because they'll have other paragraphs explaining what the exceptions are, so they'll be before this. But here is when we're going to tell you what our opinion is.

In this instance, in our opinion, the financial statements referred to above present fairly in all material respects. That statement alone is how you know that this is an unqualified financial statement, so this is a good, clean opinion. When we get to the next one you'll notice that this whole phrase, it changes.

So, when you're reviewing a report, look at the first paragraph to find out what type of report this is. In this one, we know that it's an audit because it tells you we have audited. You also will find out what period it was audited, and it will tell you specifically what periods were audited in that statement.

Then you go down, and if it's an audit, you then go down and start looking for the opinion paragraph. In this opinion paragraph, if you read the financial statements referred to above present fairly in all material respects, then you know that this is an unqualified opinion and I can rely on this.

I still have to read the financial statements because, unfortunately, even though it's an unqualified or clean report, it doesn't mean that the company is financially strong. The financial statements could be pretty negative, but it just means that they are still reported, they are still accurate and complete and presented fairly, but you still have to go through the other analysis to look at the statement of financial position and the statement of activities.

A modified is basically telling you that we can't give this an unqualified opinion for one or two reasons, either there's some kind of scope limitation where the auditor couldn't get access to information or it wasn't available, or that there's a departure from applicable financial reporting. So, there's a departure from generally accepted accounting standards, so we can't give them an unqualified opinion because, for lack of a better term, they're not following the rules for generally accepted accounting principles.

In that instance, the report looks like this. The first paragraph is still telling you that this was an audited report. You will see a paragraph that says except as discussed in the following paragraph. When you see the term "except," and sometimes, it will say except as discussed in the financial statement notes or disclosure and they'll refer you to one of the financial statement disclosures or in this instance in the following paragraph, that "except as" tells you it's a modified report.

And it will also tell you why it's modified, so then this next paragraph tells you why they couldn't, what was one of the two exceptions. In this instance, they were unable to obtain audited financial statements supporting the investment in a foreign facility, so we were not able to audit that area because we didn't get the documentation.

So, that's that scope limitation is the first one, and then when you look at the opinion paragraph, because there will still be an opinion paragraph, "In our opinion, except for," that "except for" tells you that it's a modified opinion.

So, if it's a modified or qualified opinion, then that means that in this instance this is an investment in a foreign affiliate, that they could not do the audit procedures to give you an audit opinion on that area. So, for you all, that wouldn't have any impact. That's not applicable to what you're looking at, but if the scope limitation was we didn't get enough supporting documentation to support revenues or salaries or some area where it does impact you, then that would concern you.

You might ask them a question about, okay, what corrective action did you take, and they should have a management letter that tells you what the recommendation was and what their corrective action is. You might ask to read that and put that in your file for future references. So, this opinion paragraph will have that "except for" to indicate that it's modified.

A disclaimer and pretty much we're saying we can't audit this is because of—there's only four circumstances, lack of independence, which to be quite frank, that's really the auditor's fault. If they took on an audit where they're not independent, then they should have never agreed to the audit. Because as the auditors, we should go through conflict of interest and independent statements and they shouldn't have taken the audit. I'm going to tell you that's on large organizations, not necessarily what you would see on your common not-for-profit organization financials.

[Indiscernible] limitations, if they are too pervasive, where it's not just one particular area, but pretty much you can't provide us any information to support these financials, then we'll say we just can't do it. We can't do this audit.

Substantial doubt about an organization's ability to survive—that's called growing concern. If we become aware, or let's say as we're doing your audit, your agency is losing support or has lost support, and as we're doing the audit you're in a tough financial situation, we may disclaim from doing this audit because of the uncertainty of you being in existence and we would not want a third party or the general public to rely on the financial information we're currently reporting on knowing the current financial position of the organization. That would be an auditor's [indiscernible].

And any kind of matters involving uncertainty. Let's say we're doing the audit now, but we find out while we're doing the audit that you just lost a major lawsuit that pretty much could wipe your agency out, you're not going to be able to continue, well we would disclaim from issuing those financial statements at that time and just say we can't do it.

In the disclaimer, notice we don't say audited, we say we were engaged to do it, and that's because we're telling you we did not do it. So, that's your first clue that this is a disclaimer, because unfortunately the report won't say disclaimer and it doesn't say modified. You have to understand what you're looking for.

So when you see the terminology in the opening paragraph, "We were engaged," that's your first clue. Then you will have the disclaimer paragraph, and that's that last paragraph that reads "Because of the significance of the matters discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express and we do not express an opinion." Clearly, and that's the standard language you will see, "We do not express an opinion," that's a disclaimer, where we're telling you we're not expressing a recent opinion.

And adverse, which I told you is by far the worst, this is indicating that a company's financial statements are misrepresented, misstated and do not accurately reflect the financial performance. So, pretty much we're saying you can't rely on these things whatsoever. In this instance, we still audit them, unlike the disclaimer where we say we were engaged, in this report we do say, we have audited, and then we say "As discussed in note X."

At this point, the company carries its property and asks that this is the basis for this adverse opinion, because evidentially this misstatement is so material that if you relied on it, you can make inaccurate or bad decisions if you're relying on this.

The paragraph that tells you that this is adverse, will always start with "Because of the departures from accounting principles generally accepted," when you see "Because of the departure," in our opinion, that last paragraph, "Because of the effect of the matter itself, the financial statements referred to above do not present fairly." That is the sentence that you're looking for, "do not present fairly." Remember the disclaimer said that we did not audit them. This one is telling you that they do not present fairly. That's how you know it's an adverse opinion.

If you have that kind of opinion, I would strongly recommend that if you're not an accountant that you would get additional—someone else to do an additional review because that should be alarming and that should have some kind of impact on your decision to award. Generally out there if you get some explanation, just asking some questions, that would require more in-depth review because of the severity and pretty much you're saying that the financial statements are false. Then that's a bigger issue.

Then under the OMB uniform guidance, with the single audit there are certain types of reports on how do you to look for those findings and where do you find them on these single audits. Under single audit requirements, unlike the financial statements where you just had your accountant's report, that gave the opinion, you're going to have multiple reports included for a single audit.

One of the reports is on the internal control, and then the other report is on the compliance with whatever the program compliances are. You're going to have an internal control report and you're going to have a compliance report. This is what this report looks like. We have audited. This is the internal control over financial reporting. They're going to tell you if there's any issue with that internal control. You're going to see this—in our opinion, the city complied. It's either going to be they complied or they didn't comply. Unlike the audited financial statements where you had those four types of opinions, in these single audit requirements it's going to be one or the other.

Now, one of the things I want to emphasize is every agency will not have a single audit report, and generally your financial statement report and your single audit report are two separate reports. Sometimes the independent accounting firm will do one report and the financial statement audit will be the first part of it, and then they'll have the supplementary information or other reports and then they'll include the single audit.

It's not uncommon for there to be an audited financial statement report and then a separate single audit report. They can be separate or combined. Only agencies that have a federal award of $750,000 or more in that fiscal year are required to do the single audit. So, you will either see one report or you'll see two separate reports.

One of the biggest differences between a financial statement audit and a single audit, is the single audit is just looking at that federal major program. So, all of the audit testing and procedures, internal controls, are just on that program. Your financial statement audit is looking at the entire organization, not just one particular program. So single audit is just that focus on those major programs and the procedures and testing are indicative to that major program. Financial statement audits are for the entire agency. That is the big difference.

So, when they're looking at the entire agency, these programs' compliance issues are not a part of that financial statement audit, because that's not a part of the principles and the standards and the requirements that they have to meet. It is in the single audit, where they're looking at the major program, that they would identify compliance issues.

So, someone can have a perfectly clean or unqualified financial statement with the auditor saying, oh, there was no problem, and still under a single audit have internal controls deficiencies and/or have internal compliance issues. That's because these audits are audited under different requirements, they're looking at different things from different perspectives.

Under the single audit, you also have the report on internal control over compliance. So, you're going to look for that opinion. That opinion is going to tell you the same thing. In our opinion it's going to tell you whether it complied or it didn't comply. And if it didn't comply it's going to tell you how it didn't comply. What it means to you is that a lot of times, especially with these sub-awards, this Office of Housing and Counseling grant will not show up as a major program because they're not giving them $150,000 or more.

You say, okay, if they have a single audit, why am I reviewing it? Well, you do want to go look at this schedule of findings and question costs in a single audit to see if they had any internal control weaknesses. If they did, you want to read what those weaknesses are, because even though they may not be directly related to your grant, if they are systemic or things that they're doing as a practice, indirectly, they could be doing those same things as it relates to your grant.

So although it may not be a direct impact, you need to read them to see if those efficiencies could, in fact, be deficiencies that would impact your grant and then they tell you what the corrective actions are, they tell you what the material weaknesses, and in this instance, it was segregation of duties; duties should be segregated to provide reasonable assurance, the condition. If there was a lack of segregation duties amongst city personnel, the FS [ph] transactions could be mishandled.

Now, if they're doing it with the city, that suggests to me that maybe they're doing it too with my grant, so I may ask them questions about their segregation of duties relative, or what their plan is or how do they address this, because they have a recommendation, and then for these findings they have to come up with a corrective action. You may ask them, can you please just provide me with the corrective actions from this single audit report and let me incorporate that in my file.

What you've defined as main common findings, some of the most common are lack of segregation of duties. Usually, they don't have the complete set of financial statements prepared. Then you have other findings, like question costs and reportings and are they repeat findings. So, you're reading that single audit requirement to see—it really tells you an indication, too, of how organizations address the findings that they have. If they have repeated findings, the same thing coming up, you want to ask them first for their corrective action plans, but then you also want to get an understanding of why they haven't corrected it yet, especially if those findings could indirectly impact your agency.

As you can see, I've tried to simplify it as much as possible. For you all, if you're not an accountant, one of the key things I hope you get from this is that, if in fact you find yourself with an agency who you're reviewing their financials and some of the triggers that we mentioned in here, whether they hadn't been giving you compiled financial statements, so you're not sure what you're reading, they had findings on their single audit, you read the audited opinions for the financial statements and it says it's a qualified opinion or it says they did not expect opinion, the goal is that you recognize when you may need additional help to be able to make that determination of whether they have the financial capability to perform.

If you have resources internally, you could have your accounting department review those and maybe provide you with some insight, or you can request assistance through OHC for us to do a financial analysis of those financial statements, and we do provide you with a recommendation on whether you should accept. Sometimes we recommend a financial capability assessment, which is part of the services we can provide under financial analysis.

With the financial capability assessment, we would actually do a more in-depth review. We do a questionnaire with the agencies about some of their key financial areas. We do various ratios. We obtain all of the clarifications on any areas that appear to be questionable or we need further information on.

And then we provide you with a report that you can include in your file to say, I did have a third-party analysis of our financials. Take a look. Their recommendation may be that they have the financial capability to perform or it may be that they do not. At that point, that's just a recommendation, and you all make whatever decision you deem necessary.

We can also do those financial reviews of sub-grantees as a part of financial analysis. We do a financial fitness review for high risk agencies. If you have any sub-awardees that, based on your history, there's a high risk, we can do a financial fitness to see where they are right now, and especially if they had prior issues and it doesn't appear like those issues are being addressed, we can actually do those. We can review single audit findings for you and then ask the kinds of questions and get the kinds of information needed to address those single audit findings, especially if they directly or indirectly impact your program.

Then of course we can review your grant execution packages for your sub-grantees. Some of you have used that opportunity for us to conduct those kinds of reviews, because we give you a report for your file that looks at all the financial areas of that, including understanding the financial statements and financial capability, but we're also looking at it from consistency with the budget, with the performance measures and all of those things, so that's other services that are available to you.

One of the areas that we noticed too with a lot of sub-awards, is they don't have an accounting system. And that comes out sometimes in our financial capability assessment, or we can just look at what they've sent in as a financial statement and pretty much say we don't know where this—you know, it's so inaccurate and not consistent with financial statement presentations that as we delve we find out they don't even have an accounting system, that they're still doing everything manual.

And at that point we can assist them in setting up their accounting system for this particular grant, so that they can actually account in their system for the grant, recognizing that sometimes they just don't have any system, so they're giving you—I'm not sure where it comes from because when we go delve deeply, we find out they kind of made it up as they went. That is also available to you, and it's consistent with the requirements that they have a financial management system, which is a uniform guidance requirement.

If you haven't ever requested this assistance, you will request it through your HUD POC, send them an email saying, if it's a grant execution package, we'd like for Booth to review the grant execution package for our sub-recipient. If it's I have this financial statement, I'm not sure I need a financial assessment done, you can ask for a financial analysis.

If you want to pull financial capability assessment, you would just ask for that. You make the request for your HUD POC to provide this information. Generally, our GPMs or SMEs, they're very responsive. Usually, within one to two business days those requests are edited, and unless it's outside the scope, they're usually approved. And from that point forward we contact you directly to work with you to get the information, and even in our interactions with the sub-recipients we're always mindful of whether you want to participate and including the parents or intermediaries on all the emails and things like that.

Depending on the responsiveness of the sub-grantee and the type of service, we strive to get this work done within three to five business days, but like I said, that's dependent upon the sub-awardees' responsiveness. The type of service we're providing, sometimes, like a financial capability assessment, may take more time. An accounting system review does take more time, especially if we're helping them to address the accounting system deficiencies, but we go over that with you as a part of the service.

If in fact, you need those services, you can make those requests now through your HUD POC.

Due to time, we're past the hour mark, I'll ask that any questions that you have, to please submit them to housing.counseling@hud.gov and include in the subject line, "How to Read Financial Statements." As I indicated at the beginning of the presentation, we can only respond to those questions from HUD Office of Housing Counseling stakeholders, so if it's about other grants or other programs, unfortunately, we cannot respond.

With that said, I thank you all for your time, and wish you Happy Holidays.

Moderator Ladies and gentlemen, that will conclude our conference for today. Thank you for your participation and for using AT&T Teleconference. You may now disconnect.