



Public Housing Authority Financial Management Training

# **Module 7:**

# **Financial Statements & Annual Financial Audits**





# Module 7 Topics

- Uniform Financial Reporting Requirements
- Reading and Interpreting Financial Statements
  - Annual Financial Statements
  - Balance Sheet Terminology & Analysis
  - Income Statement Terminology & Analysis
  - Budget to Actual Income Statement
- The Audit Process
  - Audit Requirements
  - Types of Audits and Understanding Audit Coverage
  - Steps in Procuring an Audit



## Module 7

# UNIFORM FINANCIAL REPORTING STANDARDS





# Uniform Financial Reporting Standards (UFRS)

- The UFRS Rule (24 CFR Part 5, Subpart H) requires PHAs to submit financial data to HUD. Specifically, the UFRS Rule states:
  - PHAs must submit data electronically
  - Financial information must be prepared in accordance with Generally Accepted Accounting Principles (GAAP)
  - Unaudited submissions to REAC are due no later than two (2) months after the end of the PHA's fiscal year
  - Audited submissions to REAC and the local Field Office are due no later than nine (9) months after the end of the PHA's fiscal year
  - PHAs are responsible for the timely submission of data (not fee accountants or auditors)







# Generally Accepted Accounting Principles (GAAP)

- Generally accepted accounting principles (GAAP) is a term that refers to a set of rules, standards, and practices used throughout the accounting industry to prepare and standardize financial statements that are issued to outside entities
- The Governmental Accounting Standards Board (GASB), a private, non-governmental organization, is the source of GAAP used by state and local governments, including almost all PHAs
- Accounting rules and principles were developed to promote the accuracy and completeness of financial statements and to create a common basis of understanding that facilitates communication between accountants and end users
  - The basis of accounting determines when transactions will be recorded and what transactions will be recorded





# Enterprise Fund Accounting

- Most PHAs account for their programs as an enterprise fund type, which uses a measurement focus known as the “flow of economic resources” and uses (full) accrual accounting
- The "flow of economic resources" measures all assets that are available to the entity, not only cash or soon to be cash assets. Long-term assets, long-term liabilities, and depreciation are recorded
- Accrual accounting requires revenues to be recorded during the period when they are earned and become measurable. Expenses are recorded during the accounting period when they are incurred as long as they are measurable
  - For example, if the PHA requested \$50,000 of Capital Funds to cover eligible CFP expenses, the PHA would record \$50,000 as revenue even if the funds had not been released by HUD





# Enterprise Fund Accounting (continued)

- Recording of Certain Transactions
  - Not all resources available to the PHA are reported in the PHA's financial statements
    - Capital Fund grant revenue is recorded when there is an eligible expense, therefore the financial statements do not show how much of the CFP grants are remaining
    - Similarly, HCV annual budget authority and program reserves are recorded when earned and therefore the financial statements do not show how much annual budget authority and program reserves is held by HUD on behalf of the PHA
  - Contract commitments / encumbrances are not recorded in financial statements
  - Purchases of capital assets are not recorded as an expense
- Monthly financial statements are normally on a cash basis of accounting
  - Certain transactions and accruals are normally completed only at year end, which can result in a material adjustment to the financial statements



## Module 7

# READING & INTERPRETING FINANCIAL STATEMENTS







# Annual Financial Statements

- Annual Financial Statement consist of:
  - Management Discussion and Analysis
  - Balance Sheet (also referred to as a Statement of Net Position)
  - Income Statement (also referred to as a Statement of Operations, Statement of Activities, or Statement of Revenue and Expenses)
  - Statement of Cash Flows
  - Notes to the Financial Statements



# What is a Balance Sheet?

- A balance sheet (similar to a Statement of Net Position) is a snapshot of the agency's financial position on a given day (usually the last day of each month)
- Simply, the balance sheet provides the reader a list of the value of the accounts (assets and liabilities) on a specific date



# Balance Sheet Terminology

- Assets represent items of value and ownership that could eventually be converted to cash such as cash, accounts receivables, equipment, and buildings
  - Current Assets: Assets that can easily be converted to cash (normally within a year)
  - Non-Current Assets: Assets used for operations with an expected life of several years
- Liabilities represent an obligation arising from past transactions which typically must be paid with cash
  - Current Liabilities: Liabilities typically due to be paid within one year
  - Non-Current Liabilities: Liabilities that are typically not due within the next operating cycle (12 months)
- Net position represents the net value of assets over liabilities





# Analyzing Balance Sheets

- Analyzing a balance sheet typically requires the comparison between balance sheets
- Types of analysis:
  - Compare balance sheets between projects
  - Compare current balance sheet to previous year's balance sheet
  - Review key components and benchmarks
  - Key account balances to analyze include:
    - Cash/Investments
    - Tenant Accounts Receivable
    - Inter-Program Accounts (Due To/Due From)
    - Accounts Payable







## Analyzing Balance Sheets (continued)

- For example, the cash balance reported on the balance sheet as of 3/31/2017 was \$135,000 (including investments). The cash balance reported as of 3/31/2016 was \$147,000
- By comparing the two balance sheets, a reader would notice a reduction of cash in the amount of \$12,000 from the previous year



# Income Statement

- An income statement is a financial statement that shows revenue, expenses, and income/(loss) during a specific period, usually presented on a monthly or year-to-date basis depending on the specific report formats
- The income statement may also be titled Statement of Operations, Statement of Activities, or Statement of Revenue and Expenses
- The income statement's format can be different depending on the accounting system or accountant





# Income Statement Terminology

#	Component	Description
1	Operating Revenue	Is defined as revenue earned from the day-to-day operations of the program
2	Operating Expenses	Is defined as expenses incurred from the day-to-day operations of the program
3	Operating Income (Loss)	Is defined as the amount calculated by subtracting operating expenses from operating revenue
4	Other Financial Items	Are items that have been earned or a cost that is not a typical part of operations (e.g., insurance proceeds)
5	Net Income (Loss)	Is the total of all revenue and expense items and other financial items



# Net Operating Income

- The difference between the operating revenue and operating expense is typically referred to as net operating income (NOI)
- Net operating income provides a calculation as to whether typical operating revenue earned is sufficient to meet operating expenses

Operating Revenue	Operating Expenses
<ul style="list-style-type: none"><li>• Dwelling Rent</li></ul>	<ul style="list-style-type: none"><li>• Payroll Costs (Admin, Maintenance, Tenant Services)</li></ul>
<ul style="list-style-type: none"><li>• HUD Operating Fund</li></ul>	<ul style="list-style-type: none"><li>• Administrative</li></ul>
<ul style="list-style-type: none"><li>• Other Tenant Charges</li></ul>	<ul style="list-style-type: none"><li>• Maintenance</li></ul>
<ul style="list-style-type: none"><li>• Other Income (vending, cell towers, community room rental, etc.)</li></ul>	<ul style="list-style-type: none"><li>• Utilities</li></ul>
	<ul style="list-style-type: none"><li>• Tenant Services</li></ul>
	<ul style="list-style-type: none"><li>• General/Insurance</li></ul>
	<ul style="list-style-type: none"><li>• Depreciation</li></ul>







# Depreciation Expense

- An expense that is an allocation of costs associated with the purchase of non-land capital assets
- Depreciation expense is referred to as a non-cash expense because the depreciation expense entry does not involve a cash payment. Cash payment occurred when the capital asset was purchased
- Users of income statement information need to understand the affect that depreciation have on reported net income

	A	C
1	<b>Summary Income Statement</b>	<b>YTD</b>
2	<b>Operating Receipts:</b>	
3	Dwelling Rental	75,000
4	Excess Utilities	5,000
5	Operating Subsidy	115,000
6	Interest Income	1,000
7	Other Income	4,000
8	<b>Total Operating Receipts</b>	<b>\$200,000</b>
9	<b>Operating Expenses:</b>	
10	Administrative Expenses	\$75,000
11	Utilities	\$25,000
12	Maintenance	\$65,000
13	General Expenses	\$15,000
14	Depreciation Expense	\$30,000
15	<b>Total Operating Expenses</b>	<b>\$210,000</b>
16	<b>Total Operating Income/Loss</b>	<b>-\$10,000</b>
17	<b>Total Operating Income/Loss, Net of Depreciation</b>	<b>\$20,000</b>

# Example of Depreciation Accounting

- Purchase of a truck for \$25,000 which will be used for five years

Select Accounts on Balance Sheet							
<i>Account</i>	<i>Beginning</i>	<i>Purchase</i>	<i>Year 1</i>	<i>Year 2</i>	<i>Year 3</i>	<i>Year 4</i>	<i>Year 5</i>
Cash	\$100,000	\$75,000	\$75,000	\$75,000	\$75,000	\$75,000	\$75,000
Capital Assets							
Truck	\$0	\$25,000	\$25,000	\$25,000	\$25,000	\$25,000	\$25,000
Accum. Depreciation	\$0	\$0	(\$5,000)	(\$10,000)	(\$15,000)	(\$20,000)	(\$25,000)
Capital Assets, Net	\$0	\$25,000	\$20,000	\$15,000	\$10,000	\$5,000	\$0
Total Net Position	\$100,000	\$100,000	\$95,000	\$90,000	\$85,000	\$80,000	\$75,000
Select Accounts on Income Statement							
<i>Account</i>		<i>Purchase</i>	<i>Year 1</i>	<i>Year 2</i>	<i>Year 3</i>	<i>Year 4</i>	<i>Year 5</i>
Purchase of Truck		\$0					
Depreciation Expense			\$5,000	\$5,000	\$5,000	\$5,000	\$5,000
Net Income / Loss		\$0	\$5,000	\$5,000	\$5,000	\$5,000	\$5,000



# Budget to Actual Income Statement

- The income statement will compare not only the YTD actuals versus budget, but also may compare the monthly actuals versus the monthly budget
- The budgeted amounts are calculated by taking the monthly operating budget and multiplying it times the number of months
  - Example (see Financial Statements Package - Budget to Actual Income Statement)



## Module 7

# ANNUAL FINANCIAL AUDIT REQUIREMENTS







# Housing Authority Annual Financial Audits

- An audit is defined as an examination of the PHA's financial statements to verify that the records present a fair and accurate representation of the PHA's financial position and an examination of the PHA's compliance with laws and regulations
- While the audit is an important financial management tool, the audit provides limited assurance and does not replace the need for proper financial management controls





# Housing Authority Financial Annual Audits (continued)

- Federal regulations require that PHAs expending \$750,000 in Federal fund must have an audit completed (i.e., Single Audit)
- Certain states require PHAs to have an audit conducted, regardless of size / funding
- The audit must be filed with the:
  - Federal Clearing House (Single Audit only)
  - HUD Field Office, including management letter,
  - Electronically in HUD’s Financial Assessment Subsystem for Public Housing,
  - The individual state auditor’s office (if required), and
  - Local city / county (if required)
- Note: If the PHA has requested and received operating subsidy to cover the cost of the audit, the PHA must complete and provide the audit to REAC and the field office within nine months (Part A, Line 10: Add-on - Cost of Independent Audit; Form: HUD- 52723 Calculation of Operating Subsidy)





# Audit Types

- Single Audit: Required if the PHAs has \$750,000 or more in Federal awards expended in a given year
  - Financial Statement Audit
  - Compliance and Internal Control Testing at the Financial Statement Level
  - Compliance and Internal Control Testing at the Program Level
- Yellow Book (Government Auditing Standards (GAS)) Audit: Required if the PHAs has less than \$750,000 in Federal awards expended in a given year and is having an audit conducted
  - Financial Statement Audit
  - Compliance and Internal Control Testing at the Financial Statement Level





# PHA Audits – Portfolio Snapshot

- There are approximately 3,900 active PHAs
- As a portfolio, roughly 54% of PHAs are required to have a single audit
- Another 37% of PHAs elect to have an audit or are required by state law to have an audit
- Smaller PHAs that are not required to have an audit should consider having an audit completed. In particular, smaller PHAs with a public housing program should have an audit completed because the cost of the audit can be offset through the request of additional operating subsidy (Part A, Line 10: Add-on - Cost of Independent Audit; Form: HUD-52723 Calculation of Operating Subsidy)

Audit Type	Count of PHAs	Percent of PHAs
Single Audit	2,097	54%
Non-Single Audit	1,437	37%
No Audit	350	9%
Total	3,884	100%







# Understanding Audit Coverage

- **Yellow Book (GAS) Audit:** The auditor is not required to perform program level compliance testing but needs only test compliance areas that could have a material effect on the financial statements
- **Single Audit:** The auditor is required to perform program level compliance testing but the program testing may need only to be performed once every 3 years depending on the program's size relative to a PHA's operation as a whole
- **Effect of Findings from Other Reports:** As part of the assessment of risk to the PHA, the auditor will ask the PHA if there has been a recent OIG or HUD review and the results of such reviews
  - Depending on the type of finding, the auditor may or may not examine the area that is the focus of the finding
  - The auditor is required to perform an independent review to assess whether a finding is warranted and the risk of that finding on the audit procedures
  - The decision of the auditor on whether to review the area or item noted by the finding would not be found in the audit report





# Yellow Book – Compliance Audit Coverage

- Auditor testing of compliance focuses on compliance areas that could have a material effect on the financial statements and not on material effects of compliance at the program level

Account	Programs			Financial Statement Totals	
	Low Rent	Capital Fund	HCV	Total	% of Total
Net Tenant rental revenue	\$ 247,829	\$ -	\$ -	\$ 247,829	27.4%
HUD PHA operating grants	\$ 222,874	\$ 41,887	\$ 286,953	\$ 551,714	61.0%
HUD PHA capital grants	\$ -	\$ 95,478	\$ -	\$ 95,478	10.6%
Fraud recovery	\$ -	\$ -	\$ 1,024	\$ 1,024	0.1%
Investment income	\$ 241	\$ -	\$ 147	\$ 388	0.0%
Other revenue	\$ 7,816	\$ -	\$ -	\$ 7,816	0.9%
<b>Total Operating Revenue</b>	<b>\$ 478,760</b>	<b>\$ 137,365</b>	<b>\$ 288,124</b>	<b>\$ 904,249</b>	<b>100.0%</b>





# Single Audit Coverage

- 2 CFR 200 Subpart F: Audit Requirements - Requires the auditor to use a risk based approach to determine what federal programs are audited for compliance
- The risk-based approach takes into consideration the:
  - Overall risk of the entity (high risk or low risk),
  - Size of the federal programs (in terms of federal dollars spent), and
  - Inherent risk in each of the federal programs themselves
- Only 20% (for PHAs categorized as low risk) or 40% (for PHAs categorized as high risk) of the federal awards need to be audited





# Single Audit Coverage (continued)

- Example of Auditor Testing for Program Level Compliance
  - Even under a Single Audit, compliance and control testing is not completed on each program every year by design
  - Highlights the importance of PHA’s policies and procedures

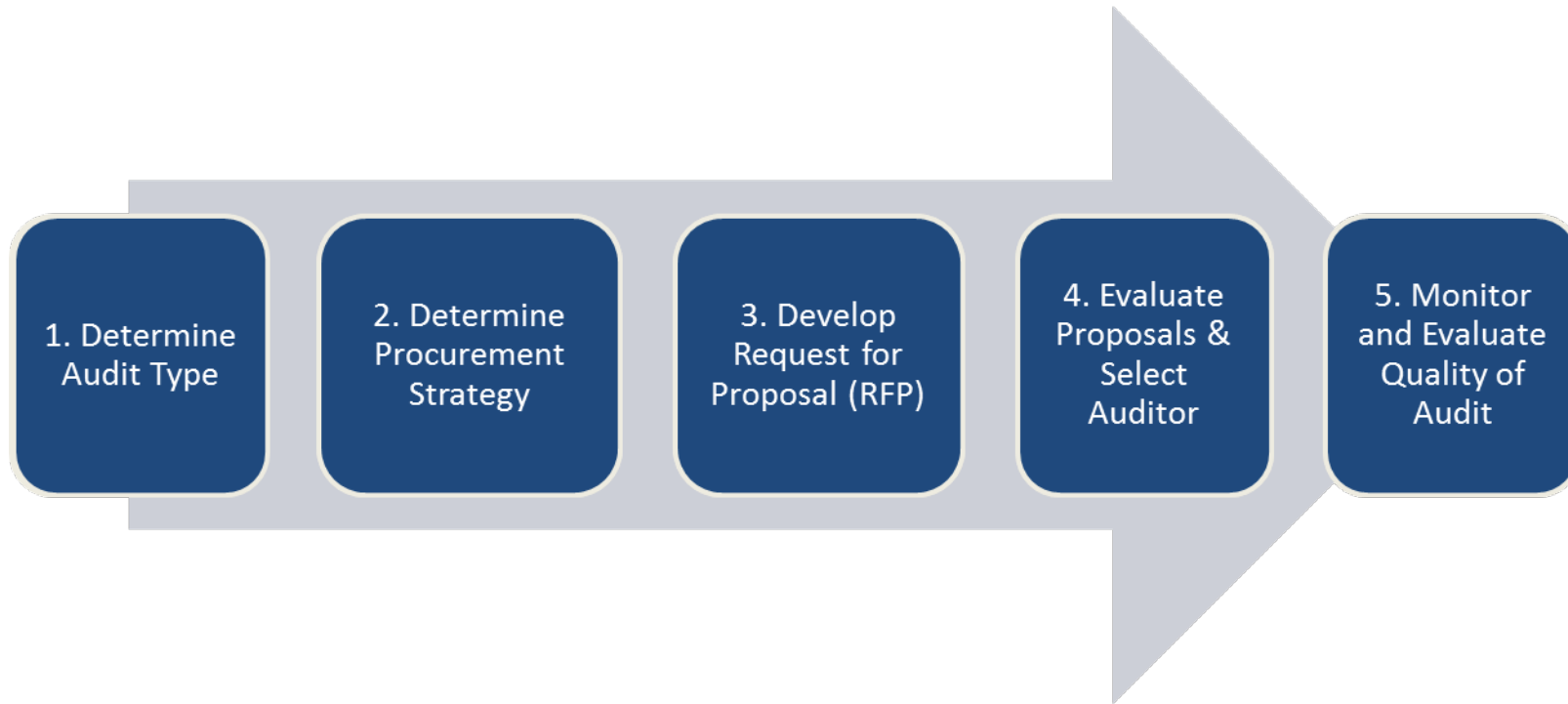
PHA Programs	Typical Year		Program Level Testing		
	Expenses	Federal Awards Expended	2013	2014	2015
Resident Opportunity and Supportive Services	\$55,000	\$53,000	No	No	No
Housing Choice Vouchers	\$4,768,000	\$4,768,000	No	Yes	No
Public Housing Capital Fund Program	\$1,214,000	\$1,214,000	Yes	No	No
Low Rent Public Housing	\$7,803,000	\$4,868,000	Yes	No	Yes
State and Local Programs	\$165,000	\$0	No	No	No
Central Office Cost Center	\$1,178,000	\$0	No	No	No
<b>Total</b>	<b>\$15,183,000</b>	<b>\$10,903,000</b>			







# Audit Procurement Steps





# Procuring an Audit

- **Step 1: Determine the type of audit needed (if required)**
  - Single Audit or
  - Yellow Book (GAS) Audit
  - The PHA should consider the cost/benefit impact of having an audit conducted if not required
- **Step 2: Determine procurement strategy**
  - Competitive (preferred for professional services)
  - Small Purchase (can be used for professional services)
  - Sealed Bid (awarded to lowest responsible bidder)
  - Non-competitive / Sole Source





## Procuring an Audit (continued)

- Step 3: Develop the request for proposal (RFP)
  - Scope of Work
    - What will the auditor provide versus the PHA (i.e., templates for financial statements, MD&A, and footnotes)
  - Required services (e.g., will the audit firm be required to provide the REAC agreed upon procedures for the transmission of the audit and opinion on the financial data schedule)
  - Audit schedule
  - Length of contract (number of option periods: maximum permitted is 5 years – initial period plus four (4) option periods)
  - Evaluation criteria (i.e., on what basis will the PHA select the auditor)





## Procuring an Audit (continued)

- Step 4: Evaluate the proposals and select an auditor
  - Is the auditor licensed in the state?
  - What is the audit firm's bandwidth (number of staff versus number of engagements)?
  - How many PHAs does the firm audit?
  - What are the experience and credentials of the auditor that will be in charge of the work?
  - What are the experience and credentials of staff that will perform the work?
  - What is the amount of time that the firm normally spends at the PHA as part of the audit?
  - Has a REAC QASS review been completed and if so what were the results?
  - Has the auditor had a satisfactory peer review?
  - What are other PHAs' experience with the proposing firms?
  - What is the cost, including option periods?
  - Is the PHA interested in a quality audit or is the PHA opinion shopping?







## Procuring an Audit (continued)

- Step 5: Monitor the progress and evaluate the quality of the audit
  - Has the auditor started their work in the timeframe agreed upon?
  - Is the staff that was proposed to complete the audit actually working the audit?
  - Is the work properly supervised by an experienced auditor?
  - Are you explaining to the auditors how the programs work and what they are reviewing?
  - Was the field work completed in the time frame agreed upon and did the audit firm spend a reasonable amount of time onsite?

**The goal should be to transmit the audit two months ahead of the due date**





# End of Module

**This Ends the Training Module on  
Financial Statements & Annual Financial Audits**

