

PHA Financial Management Training
Module 7 – Financial Statements & Annual Audit
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Slide 1: (Title Slide) Module 7: Financial Statements & Annual Financial Audits

Welcome to the Public Housing Authority Financial Management Training. This session will focus on Financial Statements and Annual Financial Audits.

Slide 2: Module 7 Topics

Module 7 focuses on the general annual financial reporting requirements of a public housing authority. Specifically, this session will discuss HUD’s Uniform Financial Reporting rule, which requires PHAs to provide annual financial data to HUD in a prescribed format. Secondly, the session will provide an overview of basic financial statements, most notably the statement of net position (also known as the balance sheet) and the income statement. Finally, this module will cover the different types of financial audits that a PHA may be required to undergo, discuss the differences in the audit types, and provide the major steps that need to be taken by most PHAs to properly procure an audit.

Slide 3: (Section Break) Uniform Financial Reporting Standards

This section titled Uniform Financial Reporting Standards will focus on PHA financial reporting requirements under this HUD regulation.

Slide 4: Uniform Financial Reporting Standards (UFRS)

The Uniform Financial Reporting Rule, commonly referred to as UFRS, is codified in 24 CFR Part 5, Subpart H and was first issued in September of 1998. The goal of the rule was to implement uniform financial reporting requirements for a number of entities that receive HUD funding in order to improve HUD’s monitoring and management capability.

As related to PHAs, the rule specifically requires that all PHAs submit data electronically to HUD. The electronic portal by which a PHA submits data to HUD is known as the Financial Assessment Sub-system for PHAs or FASS-PH. FASS-PH is a web based system that can be accessed through HUD’s Secure Systems. All PHAs are required to submit financial data to HUD using the FASS-PH system, including Public Housing only PHAs, Section 8 only PHAs and combined PHAs regardless of program / project size or total funding.

The UFRS rule also requires that financial information be prepared in accordance with Generally Accepted Accounting Principles (GAAP). At the inception of the rule, the requirement to report under GAAP was a major change for PHAs. Prior to the UFRS rule and conversion to GAAP, PHAs followed HUD’s basis of accounting.

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The UFRS rule also requires an unaudited submission of financial data by all PHAs no later than two (2) months after the end of the PHA's fiscal year. For those PHAs that have an audit, the rule requires a second submission of audited financial data due no later than nine (9) months after the end of the PHA's fiscal year. For those PHAs that are assessed under the Public Housing Assessment System, penalty points will start accruing after the 15th day after the submission due date (two months) for the unaudited submission. A PHA can request an extension of time for the due date for the unaudited submission or a waiver request for additional time for the audited submission due date, if there is good cause. PHAs should request an extension and waiver 15 days prior to the due date for the unaudited submission in the Integrated Assessment Subsystem (NASS) and 30 days prior to the due date for audited submissions. Waiver requests are submitted in hard copy to the PHA's local field office. While all PHAs can request such extensions and waivers, PHAs are cautioned that the extension or waiver request may not be approved by HUD.

Finally, the UFRS rule states that the PHAs are responsible for the timely and accurate submission of data (and not fee accountants or auditors). In essence, HUD is explicitly stating that it is the PHA's fiduciary responsibility to manage the PHA's financial reporting and recording to include the year-end closeout process, financial statement preparation and audit process.

Slide 5: Generally Accepted Accounting Principles (GAAP)

Generally accepted accounting principles or 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.

Ensuring that the financial information is presented in a uniform fashion is very important as it allows all users of such information to make informed decisions and improves the transparency of the organization, in this case, the PHA.

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. An example of an accounting standard set by GAAP is the standard for when a PHA must recognize a revenue or expense in their financial statements and for what amount. The use of GAAP is essential to accurate financial reporting and recording and allows HUD to ensure accurate funding determinations.

The Governmental Accounting Standards Board or GASB, is a private, non-governmental organization, and is responsible for issuing the GAAP that is used by state and local governments, including almost all PHAs.

A small number of PHAs are considered non-profits. The Financial Accounting Standards Board or FASB, is also a private, non-governmental organization and is the source of GAAP used by non-profits.

Slide 6: Enterprise Fund Accounting

The goal of this section of the training is not to make you an accountant or CPA, but to have you understand some important concepts related to GAAP accounting and enterprise fund accounting. For example,

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- GAAP accounting also includes the concept of accrual accounting as well as cash accounting;
- In GAAP accounting not all of the PHA's available resources will be shown on the PHA's financial statements; and
- In GAAP accounting, the PHA's financial statements will not necessarily reflect a liability for funds that the PHA may have committed, such as a contract where work has not yet started.

The goal of this session of training is to have you be able to read a set of financial statements and be comfortable asking your Executive Director, finance director, fee accountant or auditor questions about the financial information that is provided.

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.

Slide 7: Enterprise Fund Accounting (continued)

Under enterprise fund accounting, not all resources that are available to a PHA would necessarily be reflected in the PHA's financial statements, most notable are Capital Fund grants and HCV annual budget authority and program reserves.

For example, the PHA may receive a Capital Fund grant in the amount of \$250,000. The PHA will report the grant revenue only when the PHA has an eligible expense that it can charge against the grant, with the amount recognized as revenue equal to the eligible expense. If the PHA spent \$150,000 of its CFP grant on modernization of a property, the PHA's financial statements would reflect only \$150,000 in grant revenue and in no way would the unspent Capital Fund Grants of \$100,000 be reflected in the PHA's financial statements.

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 are held by HUD on behalf of the PHA.

Other items that are not reflected in a PHA's financial statement are contract commitments sometimes referred to as obligations or encumbrances, meaning the PHA has signed contract with the vendor but no work has yet been completed. The purchases of capital assets are reflected via depreciation expenses which will be discussed more in depth later in this module.

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Another item to remember is that monthly financial statements are normally on a cash basis of accounting and will be adjusted (sometimes materially) at year end when certain transactions and accruals are completed and posted into the PHA's books of account. PHAs are required to report in FASS on an accrual or modified accrual basis.

Even with the complicated accounting rules, monthly and year-end financial statements provide a wealth of information for financial monitoring. Most PHAs will supplement their financial monitoring and analysis efforts with different supporting schedules and reports, which will provide a fuller view and understanding of the PHA's financial condition. For example, PHAs have internal reports and budgets which provide details on open CFP grants, what was spent and the CFP grant amount remaining. Similarly, PHAs will normally maintain a contract schedule which shows all executed and planned contracts, funding source, amounts invoiced, etc. to help manage the PHA's cash flow position.

Slide 8: (Section Break) Reading & Interpreting Financial Statements

This section titled "Reading and Interpreting Financial Statements" will focus on a general understanding of financial statements and the methods that can be used to analyze them.

Slide 9: Annual Financial Statements

Annual financial statements are also known as basic financial statements. The financial statements are comprised of: the Management's Discussion and Analysis or MD&A; the balance sheet (also referred to as the Statement of Net Position); an income statement (the income statement is also referred to as a statement of operations, statement of activities, or the statement of revenue and expenses); a statement of cash flows; and the notes to the financial statements. The statements in this format are typically prepared at the end of the fiscal year and reported as part of the audited financial statements.

In this section, the focus of the training will be on two important reports – the balance sheet and the income statement.

Slide 10: What is a Balance Sheet?

A balance sheet, more formally known as the Statement of Net Position, provides the user with a snapshot of the agency's financial position as of a certain day, usually the last day of the month or fiscal year. The balance sheet provides a list of assets owned by the agency and the liabilities due as of a specific date. The difference between the PHA's assets and liabilities is known as the PHA's net position, which was previously referred to as equity.

In conceptual terms, net position can be thought of as what is the PHA worth at a point in time. For example, if a PHA's balance sheet shows that the PHA has \$1,000,000 in assets, for example in cash and buildings and owes \$600,000 to different third parties, the PHA would have a net worth or net position of \$400,000.

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Slide 11: Balance Sheet Terminology

Generally accepted accounting principles or GAAP provides the report format and terminology to be used by an accountant in the preparation of the balance sheet. Assets represent items of value that are owned by the agency. These items can be converted into available resources such as cash for continued program use. Assets are categorized into two categories: current and noncurrent assets.

Understanding the terminology of current and noncurrent is important for an agency as many of these amounts are used by HUD in calculating ratios to analyze the financial position of the agency.

Current assets are items of value, such as cash and investments and other assets that are expected to be converted cash, such as accounts receivable or consumed within one year such a prepaid insurance. Noncurrent assets are items of value that typically have a useful life of several years and may take more effort and time to convert the value into cash due to the nature of the asset. Examples of these assets include land, buildings, and equipment.

Liabilities represent obligations or debt owed by the agency from a past transaction that will typically be settled with a cash payment. Similar to assets, liabilities are also divided into current liabilities and noncurrent liabilities. Current liabilities represent obligations that should be paid within the next operating cycle (for example, within a fiscal year or earlier). Examples of current liabilities include vendor payables, wages and payroll taxes payable and accrued leave (vacation time) earned by an employee.

Noncurrent liabilities represent obligations or debts owed by the agency that are not anticipated to be paid or come due within the next fiscal year (or operating cycle). An example of a noncurrent liability may be a mortgage owed to a financial institution for improvements made to a project. The payments to be paid within the next twelve months would be reported as a current liability where the remainder of the mortgage (i.e., the portion not due until the following year) would be reported as a noncurrent liability.

The remaining balance after subtracting total liabilities from total assets is known as net position (or equity). The net position represents the value of the program.

Slide 12: Analyzing Balance Sheets

Analyzing the balance sheet is critical to the financial monitoring of the agency. In many cases, a balance sheet analysis can aid the agency in understanding whether the PHA's financial position is improving, deteriorating, or staying consistent.

Key account balances can be monitored including cash and investments, tenant accounts receivable, inter-program due to/due from accounts, and accounts payable. Each of these items provides the user an analysis of the agency's performance. Questions may arise such as: *Why is the tenant accounts receivable balance going up, meaning why are rents not being collected? Or, why are the inter-program due to/due from balances not being settled by the end of the month as many of the due to / due from balances may*

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represent non-compliance as transfers from one program to another are usually not allowed? Balance sheets can also be used to compare the key account balances between projects and programs.

In certain situations, the use of benchmarks can be used to analyze key account balances. As an example, the agency has determined that a tenant accounts receivable balance of \$4,500 is the maximum balance the agency can report to earn the maximum points for the Tenant Accounts Receivable or TAR indicator under the Public Housing Assessment System or PHAS. The tenant accounts receivable balance currently reported on the balance sheet is \$6,800. By reviewing the balance sheet, the reader can conclude that points may be reduced on the TAR indicator due to the balance exceeding the established benchmark.

Slide 13: Analyzing Balance Sheets (continued)

Another key method to analyze the financial position of the agency is to compare the current balance sheet to the prior year statement. As an example, a reader compares the current balance sheet to the balance sheet from the past year and has noted that cash decreased from a reported amount of \$147,000 as of 3/31/2016 to \$135,000 reported as of 3/31/2017, a net decrease of \$12,000. The reader then looked back at the 3/31/2015 balance sheet and noted a cash balance of \$158,000. This suggests a trend that cash balances are decreasing each year and may warrant a request for an explanation as to the cause of the decrease.

Slide 14: Income Statement

Whereas a balance sheet reports balances as of a specific date, the income statement reports income and expenses for a period of time. The time period could be one month, three months, or a fiscal year. The income statement provides the reader with amounts earned over the period, known as revenue, and the costs incurred during the period, known as expenses. The income statement is known by several names, including the statement of operations, statement of activities, or the statement of revenue and expenses.

Depending on accounting standards, software systems, and accountant's interpretation, these reports may vary in their presentation. However, the purpose of these reports is to provide the user with an analysis of the revenue earned and the costs incurred with the difference between revenue and costs typically referred to as a net income or a net loss.

Slide 15: Income Statement Terminology

Generally accepted accounting principles or GAAP accounting provides standardized terminology to provide a framework for readers to analyze the income statement. One of the fundamental terms used in the income statement is "Operating". Operating refers to the normal financial operations of maintaining the day-to-day activities of the agency. Therefore, the term operating revenue refers to the normal revenue sources earned by the agency. Operating expenses refers to the normal day-to-day costs incurred by the agency. Operating income or loss is a term that represents the difference of subtracting operating expenses from operating revenues.

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Other financial items represent a revenue source or a cost that is not a normal item within the day-to-day operations. Examples may include insurance proceeds, casualty losses, and the transfer of resources from another program or project. Other financial items are commonly reported after the net operating income or loss to allow the reader to understand the operating profit or loss before including other financial items into the final net income or loss amount reported by the PHA.

Slide 16: Net Operating Income

Net operating income or NOI provides an amount for the reader to determine whether the agency can operate within the operating revenue generated from normal operations. Major categories of operating revenue sources for a Low Rent Housing Project include dwelling rent, HUD operating subsidy, and other tenant charges. Operating expenses include normal day-to-day costs. Operating costs for a Low Rent Housing Project include ordinary maintenance, administrative costs of the project, utilities, and insurance expense, to name a few.

Slide 17: Depreciation Expense

People typically think of an expense as a payment of cash or if cash is paid then a PHA expense occurred. While this is true for many day-to-day purchases and activities, certain exceptions exist.

The largest exception is for PHAs using enterprise fund accounting and the purchase of capital assets. Under enterprise fund accounting, when the purchase of a capital asset occurs, the PHA does not recognize any expense but simply reflect an exchange of one asset type (i.e., cash) for another (i.e. truck) on the balance sheet. The cost of the truck will then be reflected over time through an account named “depreciation expense” as the value of the truck decreases over time due to age and use. The amount of time that an asset will be depreciated is related to the type of asset purchased, with equipment and computers normally fully depreciated in less time (typically 3 to 7 years) than a building which may be depreciated over 30 to 40 years. Note: land is not depreciated as land is considered to always hold its value from an accounting standpoint.

Depreciation expense is referred to as a non-cash expense because the depreciation expense entry does not involve a cash payment. The cash payment occurred when the capital asset was initially purchased.

Users of income statement information need to understand the affect that depreciation expense has on reported net income. In the example, depreciation expense (row 14) is \$30,000 and is included in total operating expense of \$210,000 (row 15), which results in a net loss of \$10,000 (row 16). While this net loss is true from an economic sense, from a cash flow standpoint the PHA actually had net income of \$20,000 (row 17) as the \$30,000 depreciation expense does not reflect a payment of cash. Therefore, users of financial statements need to understand the effect of depreciation on the PHA’s bottom line.

Participants should also understand that a PHA’s financial statements have three components of equity or net position.

1. Unrestricted Net Position,

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2. Restricted Net Position, and
3. Net Investments of Capital Assets.

The PHA funds were used to purchase the capital asset will affect the accounts differently.

The purchase of the capital assets will always increase, while depreciation expense will always decrease the PHA's net investment of capital assets account. However, the PHA's unrestricted or restricted net position account may or may not be affected based on the funding source used to purchase the capital asset.

For example, if HCV administrative fees were used to purchase the capital asset then there would be a decrease in cash for the amount paid, which would reduce the PHA's unrestricted net position. If a PHA used insurance proceeds to fix a fire damaged public housing unit, then there would be a decrease in the restricted net position account of the PHA. And, if CFP funds were used there would be no net effect on either unrestricted or restricted net position account.

Slide 18: Example of Depreciation Accounting

Here we show an example of depreciation accounting to help further clarify the concept of depreciation. In this example, the PHA purchased a truck for \$25,000, which will be depreciated over five years.

The PHA starts the year with \$100,000 in cash and no other assets and liabilities, which results in a net position of \$100,000. The PHA then purchases the truck using cash, which results in a cash balance of \$75,000 and a capital asset (that is, the truck) being booked on the balance sheet for \$25,000. The PHA's net position is still \$100,000 and the purchase of the truck has not yet affected the income statement. In year 1, depreciation expense is now booked on the income statement for \$5,000 to reflect the economic expense of the truck and the balance sheet also reflects \$5,000 in accumulated depreciation to reflect that the value of the truck is no longer \$25,000. Similar accounting entries are booked for the next four years, which result in the book value of the truck being \$0 and the net position of the PHA decreasing from \$100,000 to \$75,000. In addition, over five years, the income statement reflected \$25,000 in depreciation expense which was equal to the truck's original purchase price.

Slide 19: Budget to Actual Income Statement

A budget-to-actual income statement is frequently reported as a separate column on a financial report titled "actual-to-budget" analysis. Amounts reported in the actual income statement are compared to the approved operating budget amounts. Budgeted amounts presented in the statement may include the total annual operating budget or a prorated portion of the budget to match against the number of actual months.

Slide 20: (Section Break) Annual Financial Audit Requirements

This section titled Annual Financial Audit Requirements explains the two distinct types of financial audits a PHA may undergo, audit coverage, and the process by which a PHA should procure an audit.

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Slide 21: Housing Authority Annual Financial Audit

An audit can be 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 that should be used by PHA management and the Board of Commissioners, the audit is only one tool and provides only limited assurance.

The audit does not replace the need for proper financial management controls.

Slide 22: Housing Authority Annual Financial Audit (continued)

The U.S Office of Management and Budget (OMB) regulations, specifically 2 CFR 200 Subpart F, requires that any PHAs expending \$750,000 in Federal funds must have an audit completed. This type of audit is commonly referred to as a Single Audit.

In addition, certain states require PHAs to have an audit conducted, regardless of the size of the PHA or the PHA's funding level.

Once the audit is completed, the PHA must file the audit with various third parties.

For PHAs required to have a single audit, the audit must be filed with the Federal Audit Clearing House.

PHAs must file a copy of their audit, (regardless of the type of audit) in hard copy to their local HUD Field Office, including the management letter, if applicable. In addition, PHAs must submit portions of their audit report, electronically to HUD via the Financial Assessment Subsystem for Public Housing.

In addition, depending on the state or locality, some states require the audit be filed with the state agency, normally the state auditor's office. Also, some cities and counties require that the audit be also filed with them as part of the city or county's role in local governance.

Note: Since federal funds are used to cover the cost of the PHA audit (that is, operating subsidy, Capital Funds, HCV administrative fees,) the PHA must provide the audit to REAC and the field office within nine (9) months, regardless of the audit type.

Please note, if the PHA specially requested operating subsidy to fund the cost of the audit (see Part A, Line 10: Add-on - Cost of Independent Audit; Form: HUD-52723 Calculation of Operating Subsidy), the PHA must complete and provide the audit, even if the PHA is below the \$750,000 federal expenditure threshold and an audit is not required by the state.

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Slide 23: Audit Types

PHAs may be audited under different auditing standards. For PHAs, there are two (2) audit types and they are typically referred to as a Single Audit or a Yellow Book Audit. The Yellow book Audit is sometimes referred to as a GAS - Government Auditing Standards Audit. The Single Audit is the more stringent (that is, provides the most audit coverage) of the two audit types.

A Single Audit is required if the PHA has \$750,000 or more in Federal awards expended in a given year. A Single Audit consists of three parts:

1. An audit of the PHA's financial statements;
2. Testing of PHA's compliance to laws, regulations and internal controls at the financial statement level; and
3. Testing of PHA's compliance to laws, regulations and internal controls at the program level.

Under a Yellow Book (GAS) Audit (i.e., a PHA with less than \$750,000 in Federal awards expended), the audit consists of only two parts:

1. An audit of the PHA's financial statements;
2. Testing of PHA's compliance to laws, regulations and internal controls at the financial statement level.

Slide 24: PHA Audits – Portfolio Snapshot

For context, most PHAs (54% of HUD's portfolio) receive or are part of a government that receives over \$750,000 in Federal funding and are therefore subject to the Single Audit.

Another 37% of PHAs in the HUD portfolio receive less than \$750,000 in federal funding but either elect to have a Yellow Book Audit completed as part of their own financial management policies or are required to have an audit due to state law. Thus, 91% of all PHAs have an audit either because they are required to or do so voluntarily.

About 9% of the portfolio elects not to have an audit. Small PHAs are encouraged to have an audit because an audit allows for an independent party to review the PHA's books of account and compliance to laws and regulations. An audit is particularly useful when there is a new incoming Executive Director or PHA Board. For PHAs that operate the public housing program, 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).

Slide 25: Understanding Audit Coverage

Under both audit types the auditor will audit the financial statements, so they can provide an opinion as to the accuracy of the financial information provided.

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Under a Yellow Book 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.

In contrast, under the Single Audit, the auditor is also required to perform program level compliance testing. However, 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

For further insight, as part of the assessment of risk of the PHA, the auditor will normally inquire of the PHA if it has had a recent OIG or HUD review and the results of such reviews. The effect of an OIG audit or HUD review will inform the auditor and help them in the planning of their audit. However, the auditor is not mandated to report the findings of other auditors in their audit report for a variety of reasons.

- First depending on the type of finding or issues noted, the auditor may or may not examine the area that is the focus of the OIG or HUD finding. For example, some OIG and HUD findings relate to PHA performance (that is, the PHA should improve its occupancy rate or the PHA should issue more vouchers as the PHA has a large amount of HUD-held reserves). While these statements may very well be accurate, the finding does not directly relate to non-compliance or inaccurate financial reporting. The findings relate more to a level of PHA efficiency and PHA governance.
- Secondly, the auditor is required to perform an independent review to assess whether a finding is warranted and the risk of that finding on their audit procedures. Just because the OIG or HUD has concluded non-compliance does not mean the auditor will reach the same conclusion. Or, it could be that the PHA has already taken the needed corrective action and therefore the PHA is now in compliance.
- Finally, the decision of the auditor on whether to review the finding noted by the OIG or HUD or if the needed corrective action has already occurred would not normally be found in the audit report. For example: A HUD review conducted six month ago found that the PHA did not have a properly executed general depository agreement. Once the finding was issued, the PHA completed the corrective action by executing a general depository agreement with its bank. The auditor is not mandated to report the HUD finding in their audit report and /or indicate that the finding is now closed.

Please note, that auditors are normally required to repeat findings that remain open from the prior year audit in the current audit report.

Slide 26: Yellow Book – Compliance Coverage

Under the Yellow Book Auditing Standards, testing of compliance focuses on compliance areas that could have a material effect on the financial statements. Compliance testing is not performed at the major program level nor will all items of compliance be reviewed by the auditor.

In this example, it would be very likely that the auditor would have to review tenant files to review rent calculations as tenant rent revenue would be considered material to the financial statements and tenant

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rent is part of HUD’s funding formula for Operating Subsidy and HAP funding, which is also material. However, this does not mean that the auditor would be looking for non-financial related non-compliance such as community service documentation. Additionally, the auditor would not necessarily pick a sample of tenant files to review that is weighted between the public housing and HCV program since the testing is at the financial statements level which is a total of all the PHA’s programs.

Under a Yellow Book audit, an audit opinion of “no findings” simply means that the auditor did not find non-compliance on the sampled transactions of material accounts. However, non-compliance with laws and regulations may still exist.

Slide 27: Single Audit - Compliance Coverage

OMB (2 CFR 200 Subpart F: Audit Requirements) requires that as part of the single audit, the auditor use a risk-based approach to determine what federal programs are audited for compliance and internal controls.

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.

If the PHA is deemed to be low risk, the auditor need only audit 20% of the federal awards. If the PHA is deemed to be high risk, the auditor needs to audit at least 40% of the federal awards. Under a single audit, the auditor must also test compliance and internal control areas that could have a material effect on the financial statements (same as Yellow Book standards).

Slide 28: Single Audit Coverage (continued)

Shown here are the programs of an actual high risk PHA that were selected for compliance testing as part of a single audit over a three-year period. The federal awards expended were approximately the same for each year. Because the PHA was considered high risk, 40% of the federal award needed to be audited.

The example highlights that while there is more compliance testing under a single audit, compliance and control testing is not completed on each program every year by design. For example, in two of the three years (2013 and 2015), the HCV program was not audited even though it is the second largest program the PHA administers. In 2014 only, the HCV program was tested for compliance and the Low Rent program was not reviewed and in all years, there are a number of other programs that were never audited due to the program’s small size or, non-federal nature.

There would have been even less audit coverage (20% of federal awards) if the PHA was considered a low risk.

Users of the audit report need to understand what programs were audited. The auditor provides this information in the form of a schedule that is included in the audited financial statement report. Like the

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yellow book audit, a Single Audit that concludes there are no findings does not mean that non-compliance with laws and regulations does not exist.

The best way of ensuring compliance is to have proper policies and procedures in place at the PHA.

Slide 29: Audit Procurement Steps

Once a PHA knows or has decided to have an audit, the PHA must procure audit services by an Independent / Certified Public Account (an IPA or CPA). There are five major steps which occur in a PHA's procurement of an auditor, which is no different than the steps of any procurement action.

1. The first step is determining what the PHAs needs, in this case a Single Audit or a Yellow Book audit;
2. The second step is determining how the PHA will actually procure the audit services; What is the procurement method?
3. The third step is developing and issuing the request for proposal;
4. The fourth step is to evaluate the different audit proposals that were submitted and select an auditor; and
5. The fifth and last step is to monitor and evaluate the audit work performed.

The following slides provide detail on each of the steps.

Slide 30: Procuring an Audit

The first step in procuring an audit is to determine the type of audit that needs to be conducted: a Single Audit (again if the PHA has over \$750,000 in federal expenditures) or a Yellow Book (GAS) Audit (if the PHA has spent less than \$750,000 in federal expenditures).

For some PHAs, the PHA will not know if they will be above or under the \$750,000 threshold until their fiscal year is over. For PHAs that are close to the \$750,000 threshold, the PHA should request that the auditor provide a proposal for both types of audit services.

For small PHAs that are not required to have an audit, the PHA should consider the cost/benefit impact of having an audit conducted.

The second step in the process is to determine the procurement strategy or the procurement method. For professional services such as auditing, the preferred method of procurement is the competitive bid process. A PHA could use a sealed bid process or maybe the small purchase method, if the total award, including option periods is under \$150,000 (Federal Standard) and is under any state threshold. Many states require a competitive procurement for any contract over \$50,000.

A competitive bid process is the preferred option because this procurement method allows PHAs to evaluate more factors than just price when awarding the contract.

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Slide 31: Procuring an Audit (continued)

The third step in the process is to develop a request for proposal (RFP). Besides the audit type needed, the PHA will need to provide specific information to clarify the scope of work required and expectations under the contract to prospective auditors.

- **Scope of Work and Required Services.** Besides the audit, the RFP should be clear that the auditor needs to provide an “in relation to opinion” on the Financial Data Schedule, which is a HUD requirement as part of the audit engagement and if the auditor will be required to complete the PIH-REAC agreed upon procedures as part of the transmission of the audited financial data to REAC. In addition, the PHA should have the auditor outline what they expect the PHA to provide and what they, the auditor will provide as part of the audit engagement. For instance, some auditors will provide templates that can be used by the PHA to create financial statements, MD&A, and footnotes.
- **Audit Schedule.** The RFP should provide an end date for when the audit must be completed and the PHA should provide any known dates where auditor onsite work cannot be scheduled due to other commitments by PHA staff.
- **Length of Contract.** The RFP should identify the length of the contract. For example, the initial audit plus two option periods. Procurement rules allow for a maximum length of five years (the initial period and four option periods).
- **Evaluation Criteria.** The RFP needs to clearly identify on what basis the PHA will select the auditor. Next, we provide a list of common evaluation factors specifically related to the selection of an auditor.

Slide 32: Procuring an Audit (continued)

Step four in the process is to evaluate the proposals and select an auditor. The PHA should consider a number of items such as:

1. Is the auditor licensed in the state? If the auditor is not licensed in your state, the audit will not be accepted.
2. What is the audit firm’s bandwidth (what is the auditor’s staffing compared to the number of audit engagements and other firm work)? This question is trying to determine if the PHA can perform the audit in the timeframe requested.
3. How many PHAs does the firm audit? Overall the PHA industry is a small industry with specialized programs and accounting rules. Auditors who do not have PHA clients or only audit one or two PHAs a year, may not have the experience or knowledge to properly perform the audit engagement,

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which may result in inappropriate audit adjustments, leading to the rejection of the PHA's audit by HUD's REAC.

4. What are the experience and credentials of the auditor that will be in charge of the work and what are the experience and credentials of the audit firm's staff that will perform the work? Similar to the preceding question, but this question is specific to the auditor(s) proposal to complete your audit.
5. What is the amount of time that the firm normally spends at the PHA as part of the audit? The time needed to perform audit work onsite will vary with the size and complexity of the PHA and will also be influenced by what material was sent to the auditor in advance. However, a PHA should be skeptical of an auditor whose time onsite at the PHA is very limited. For example, most auditors will review a sample of tenant files and a review of even a small sample of files will take time. The concern is that if an auditor does not spend adequate time at the PHA, the PHA may have received and paid for a subpar audit.
6. Has a REAC QASS review been completed and if so what were the results? PIH-REAC's Quality Assurance Sub-system, is charged with, among other activities, the oversight of PHA auditors. Each year the QASS team reviews a sample of PHA auditors to ensure that the auditors comply with auditing standards. As part of the review, QASS will provide a report to the auditor of any findings or issues in their audit work. Also, QASS may initiate administration action against the auditor, if warranted. As part of the evaluation, the PHA should ask the auditor if they have had a QASS review and if so, request a copy of the report. A PHA may not want to select an auditor who was found to have many problems with their audit work.
7. Has the auditor had a satisfactory peer review? Like a QASS review, auditors work is subject to review by other CPAs. As part of the evaluation, the PHA should ask the auditor for a copy of their latest peer review report. A PHA may not want to select an auditor who was found to have many problems with their audit work.
8. What are other PHAs' experiences with the proposing firms? In addition to information provided by the auditor, PHAs should consider the experience that other PHAs have had with the proposing auditor. Due to the small size and complexity of the PHA industry, there is even a smaller number of auditors and therefore many PHAs use the same auditor.
9. What is the cost, including option periods? When evaluating the auditor price, the PHA needs to consider both the initial contract year and any option periods. Normally option periods will be less expensive than the initial period. Price should not be used as the only evaluating factor. The cost of an audit will vary depending on the size and complexity of the PHA and the auditor's fee structure. However, very low prices may indicate that the audit will not be performed in accordance with auditing standards. Similarly, PHAs should be careful not to overpay for audit services. An excessive cost does not assure a quality audit.

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10. Is the PHA interested in a quality audit or is the PHA opinion shopping? Finally, the PHA and the Board need to consider the outcome they are looking for in the audit. If the PHA wants someone to really review the PHA so they have more assurance on how the PHA is operating, then the PHA should accept that the audit may cost more, and that the auditor may issue some findings. This outcome should be contrasted with the PHA that does not want any audit findings reported for any reason. These PHAs will procure auditors who have a reputation of issuing no findings regardless of the cost. The problem with this latter approach is that the results of the audit do not provide any assurance on how the PHA is operating but may be perceived by senior management and the Board of Commissioners that the PHA is administrating its programs with high efficiency, effectiveness and in compliance with laws and regulations.

Slide 33: Procuring an Audit (continued)

The last step in the process is to monitor and evaluate the audit work, which is a required part of contract administration under procurement rules.

As a PHA you want to consider the following questions:

- Has the auditor started their work in the timeframe agreed upon?
- Is the skill set of the staff completing the audit comparable to the skill set of the staff proposed?
- Is the work properly supervised by an experienced auditor?
- Are you having to explain to the auditors how the programs work and what they are reviewing and why?
- Was the field work completed in the time frame agreed upon and did the audit firm spend a reasonable amount of time onsite?

Like for any other PHA contract, the PHA needs to ensure that the audit services received reflects both what was required by the PHA's statement of work and what was proposed by the auditor. If there is a breach of contract the PHA should take applicable action to correct the issue. In addition, PHAs can elect not to exercise the options periods and re-procure for audit services. Finally, if a PHA has significant issues with their auditor, the PHA should contact their local field office, who can then refer the auditor to PIH-REAC's Quality Assurance Sub-system.

The goal of the PHA should be to file the audit with the appropriate parties, two (2) months ahead of the due date (that is, no later than seven months after the PHA's fiscal yearend).

Slide 34: End of Training Module

This ends the training module on PHA Financial Statements and Annual Financial Audits.