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CHAPTER 5:           REQUIREMENTS FOR ANNUAL FINANCIAL  
                          REPORTS AND SUPPORTING DATA

5-1.   INTRODUCTION

This chapter discusses the annual financial statements and supporting documentation that are required by HUD at the close of each fiscal year for all HUD-insured or HUD-held mortgages associated with cooperative housing corporations. Paragraph 5-1 discusses the responsibilities and requirements for annual financial reporting. Paragraph 5-2 presents the financial statements and supporting documentation. Requirements for submitting the reports and the appropriate certification are discussed in paragraph 5-3 of this chapter.

A.     REPORTING PERIOD

1.       Fiscal Year. The financial reports must cover the entire fiscal period under review. A financial report is required even if the initial fiscal period is less than a full year. It shall contain the same statements and supporting data as required in the annual financial report.
2.       The Initial Year of Project Operations, covers the period from the beginning of operations through the end of the fiscal year established by the mortgagor. Financial statements are required even though the initial fiscal period may be less than a full year.
3.       The Partial-Year Financial Statement, covering the period from cost certification cut-off through the end of the fiscal year established by the mortgagor, shall contain the same statements and supporting data required in the annual financial report.
4.       The statement covering the period of occupancy during construction must show gross carrying charges received (excluding actual operating expenses during the period, although in certain cases accrued expenses may be allowed).

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B.     RESPONSIBILITY.

Under the terms of the Regulatory Agreement, it is the responsibility of the Board of Directors to obtain the annual financial reports and to submit copies of the reports to the HUD Field Office within 60 days after the end of each fiscal year.

C. PREPARATION.

1. The Annual Financial Statements must be prepared on an accrual basis, after making all year-end adjustments. Since the report is based on an examination of books and records of and related to the mortgagor, or entity, the mortgagor shall advise the mortgagee, at least 30 days prior to the end of the mortgagor's fiscal year, that a statement reporting the escrow, regular bank and reserve fund balances is required as of the date on which the fiscal year ends.
2. The Report shall be reviewed by an Independent Public Accountant (IPA) who is a Certified Public Accountant (CPA) or a licensed or registered public accountant having no business relationship with the mortgagor except for the performance of review, systems work and tax preparation. Such an IPA must have been certified, licensed or registered by a regulatory authority of a State or other political subdivision of the United States on or before 12/31/70. In states that do not regulate the use of the title "public accountant," only Certified Public Accountants may be used to make these reviews.

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D. CONSOLIDATED REPORTING.

A Consolidated Statement of Financial Position and Statement of Income reflecting the total operations should be submitted when:

1. A cooperative housing project has been developed in sections, wherein each section imposes a separate mortgage obligation on the single cooperative housing corporation.
2. The assets and liabilities of two or more cooperative housing corporations, each having

one or more mortgage obligations, are consolidated or merged so as to impose the mortgage obligations on a single cooperative housing corporation.

In either of the above situations, it is mandatory that the initial assets and liabilities of each mortgaged parcel be recorded in the General Ledger of each cooperative housing corporation in their original amounts at final endorsement. It is also required that a separate schedule be attached to the Consolidated Financial Statements showing the current balance due on each insured mortgage by project number.

## 5-2. REPORTING REQUIREMENTS

Financial statements provide historical information for measuring and evaluating the financial performance of a project and to provide advance warning of financial problems. According to generally accepted accounting principles, a complete set of financial statements includes at least the following four reports:

- o Statement of Financial Position (Balance Sheet)
- o Statement of Income (Form HUD-92410)
- o Statement of Retained Earnings
- o Statement of Cash Flows

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These four statements must be supplemented by notes that detail any aspects of the financial operations and reporting which are not evident from the statements themselves. In addition, HUD requires several supplementary schedules to be included with the basic financial statements. Samples of the required reports are included in Appendices 3, 7, 8, and 9.

### A. STATEMENT OF FINANCIAL POSITION

1. Definition. The Statement of Financial Position is a summary of the project's financial status at a given point in time. It documents what a project owns and what it owes as of a specific date. Primarily, the Statement of Financial Position can be used as a tool to review and evaluate the financial condition of the project and its ability to pay its legal debts as of a given date. In addition it provides a means of reviewing and evaluating the project's short-term and long-term ability to meet ongoing

expenses and future demands.

2. Discussion. The Statement of Financial Position includes an Assets, a Liabilities and Owner's Equity section. Appendix 3 includes an example of a Statement of Financial Position.

B. STATEMENT OF INCOME

1. Definition. Form HUD-92410, The Statement of Income is the second annual financial report. This statement measures the financial results of the project for the fiscal year.
2. Discussion. The Statement of Income is a list of the project's revenue and expenses for a specified period of time. The Statement of Income serves three purposes:
  - o It details all revenues for a time period, usually one year

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- o It details all expenses for the same period
- o It calculates the net income or loss of the period by subtracting the expenses from the revenue.

The Statement of Income has three parts:

- o Revenue
  - o Expenses
  - o Net Income (or Loss)
- a. Revenue. Revenue is the flow of cash into the project from various sources. There are four types of revenue:
    - o Carrying Charges
    - o Financial Revenue
    - o Service Revenue
    - o Other Revenue

Note: Any receipts for services or facilities properly classified as "Miscellaneous" or "Service" or "Other" revenue, as provided under the Chart of Accounts

in Chapter 6, shall be fully identified as to the services or facility provided.

Note: If gross potential unit carrying charges reported differs from that shown on the Form HUD-92547A, Rent Increase Worksheet for Subsidized Projects, a detailed statement accounting for the difference must be attached.

Note: Receipts from donations, subsidy payments, and similar amounts earned during the current year shall be reported and fully identified.

Note: A full explanation is required concerning any receipts from charges for facilities or services, other than

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reimbursement for breakage or damage by members.

b. Expenses. Expenses are outflows of assets (e.g. cash) or increases in liabilities, (e.g., payables). They occur in connection with providing the housing services which generate revenue. Project expenses can be categorized into the following groups:

- o Sales Expenses
- o Administrative Expenses
- o Utilities Expenses
- o Operating and Maintenance Expenses
- o Taxes and Insurance
- o Financial Expenses
- o Depreciation Expenses
- o Corporate or mortgagor entity expenses

Note: Any apartments or commercial space occupied but not producing revenue must be shown as an expense under the applicable expense classification, and a supporting schedule must be submitted to convey the names of such occupants and their connection with the project. If no such expense applies, it shall be

so indicated on the statement.

Note: Any expenses reported for salaries or other compensation to supervisory or administrative employees, officers, directors, or stockholders must be supported by a schedule showing duties, salary paid, and date of prior written HUD approval.

C. STATEMENT OF RETAINED EARNINGS.

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1. Definition. The Statement of Retained Earnings represents the accumulated earnings minus dividends declared from the beginning of the project to the present.
2. Discussion. The Statement of Retained Earnings is a historical statement and account. The two accounting entries that affect this statement and account are: 1) periodic transfer of net income (or loss) from the Profit or Loss summary account and 2) dividends or refunds paid to members.

D. STATEMENT OF CASH FLOWS.

1. Definition. The Statement of Cash Flows is a complete listing of all cash receipts and disbursements for an accounting period. It lists funds provided and applied for all cash and certain non-cash outlays (e.g. depreciation) to reflect a net increase/decrease in cash during the operating period.
  2. Discussion. The statement shall include no less detail than that shown in the example in Appendix 8 and may include footnotes, if applicable. It shall be prepared on a cash basis and shall include all receipts, i.e., carrying charges revenue, concessions, commercial property, advances by owner, releases from the Reserve for Replacements, parking, etc. It shall also include all disbursements, whether by check or in cash. In addition, a schedule of funds in the bank shall include a list showing each depository by name, account title, and balance.
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E. NOTES TO THE FINANCIAL STATEMENTS.

Notes to the Financial Statements include information relative to the mortgagor organization and policy changes affecting the preparation of financial statements and account balances, as well as significant accounting policies that have been followed in the preparation of the financial statement by the mortgagor's accountant.

F. SUPPORTING DATA

Supporting data in the form of explanatory comments or appropriate schedules must accompany the financial statements. This information must include the following:

1. Accounts and Notes Receivable. A complete, detailed analysis shall be included of any accounts or notes receivable other than regular members accounts, including date acquired, original amount, terms, name of borrower and balance due.
2. Delinquent Member Accounts Receivable. A summary analysis shall be made of delinquent member accounts, including the number of members and amounts delinquent for 30 days, 30-60 days, 60-90 days, and over 90 days.
3. Mortgagor Escrow Deposits. A breakdown shall be made of the items making up the total amount on deposit with the mortgagee in anticipation of future disbursements for mortgage insurance premiums, taxes, property insurance, etc. This amount shall be confirmed in writing by the mortgagee.
4. Member Deposits. A complete, detailed analysis shall be included of funds maintained in any regular member accounts.

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5. Reserve Funds. An analysis shall be made of

all required reserve funds, including:

- a. A statement as to the amount required. If establishment of more than one fund is required, a separate statement must be submitted for each fund.
  - b. A statement as to the form in which these funds are provided. If in cash, the names of the depository of each fund are required, if invested in securities, full details are required.
  - c. A statement of any withdrawals during the year, including the purpose of and authority for such withdrawals.
6. Accounts Payable. A list shall be included of accounts payable, other than trade creditors, segregated by those payable within 30 days, 30-60 days, and more than 60 days, with detailed analysis of the latter group, to include date incurred, original amount, purpose, terms, creditor, and balance due. Accrued expenses shall be shown separately from accounts payable.
  7. Accrued Taxes Payable. A statement shall be attached supporting any accrued taxes shown, including each type of tax, basis for the accrual, and date due.
  8. Residual Receipts. For all projects required to make deposits to a residual receipts fund, a computation shall be included showing the amount of any such receipts at the end of the fiscal year and the date of their deposit to the fund. An analysis of this fund and the computation are required regardless of whether or not residual receipts have actually been generated.

9. Change in Fixed Asset Accounts. A schedule in the form required by HUD shall be included, showing full details and explanations of any Changes in Fixed Asset Accounts.
10. Compensation of Officers. Since cooperatives are usually owned by a corporation, a statement



detailing the Compensation of Officers is required. If no compensation was paid, a statement to that effect will suffice.

11. Listing of Identity of Interest Companies and Activity. A listing of identity-of-interest (as defined below) companies doing business with the mortgagor and/or management agent of the project, along with a breakdown of services rendered and amounts received, shall be required if the payments for services performed for the project totalled \$1,000 during the operating period.

HUD assumes an identity of interest to exist between the project board of directors and the lender/vendor when (1) any officer or director of the project; or (2) any person who directly or indirectly controls 10 percent or more of the project's voting rights; or is also (1) an officer or director of the lender/vendor; or (2) a person who directly or indirectly controls 10 percent or more of the lender/vendor's voting rights or (3) directly or indirectly owns 10 percent or more of the lender/vendor. A vendor is any individual or establishment that provides goods or services of any kind to the project for compensation or remuneration.

12. Unauthorized Distribution of Project Income. If any unauthorized distribution of project income is revealed during the review, a separate schedule must be prepared detailing the amounts involved, date of distribution and any other relevant information.

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### 5-3. REPORT SUBMISSION REQUIREMENTS

#### A. INTRODUCTION

The cooperative board of directors should consider the following IPA issues relating to the preparation of the reviewed statements:

1. All cooperatives with insured or HUD-held mortgages must comply with the requirements of this Handbook. Annual reviews performed under OMB Circular A-133 Audits of Institutions of Higher Education and Other

Non-Profit Institutions must also comply with the requirements stated here.

2. Independent Public Accountants (IPAs) that perform bookkeeping services for a cooperative, are prohibited from performing reviews of the cooperative.
3. To the extent permitted by GAAP/GAS, IPAs may rely on physical inspections of project made by HUD or mortgagees.
4. The mortgagor's records consist of prior year IPA reviews, HUD Management Reviews, HUD/Mortgagee physical inspection reports and HUD-OIG reviews. This information should be provided to IPAs and should be stated in the IPA engagement letter.
5. When conducting compliance tests for Affirmative Fair Market Housing Action Plans, IPA should be limited to verifying that such a plan exists, if required by the Regulatory Agreement. In addition, IPAs should sample some items, (e.g., advertising expenses) to check for compliance.

B. ACCOUNTANT'S CERTIFICATION.

1. Financial Statements Review. An independent public accountant shall review the books and

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records of the mortgagor and shall furnish an opinion on the annual financial statements. The independent accountant shall justify any material departure from the "unqualified opinion" language as illustrated in Appendix 10.

2. Internal Control Structure. An independent public accountant shall obtain an understanding of the project's internal control structure and shall furnish a written report on their understanding of the entity's internal control structure and the assessment of control risk made as part of a financial statement audit. This report may be included in either the auditor's report on the financial audit or a separate report. The independent accountant shall justify any material departure from the

"unqualified opinion" language as illustrated in Appendix 11.

3. Compliance with applicable laws and regulations. An independent public accountant shall prepare a written report on their tests of compliance with applicable laws and regulations. This report, which may be included in either the report or the financial audit or a separate report, should contain a statement of positive assurance on those items which were tested for compliance and negative assurance on those items not tested. It should include all material instances of noncompliance and all instances or indications of illegal acts which could result in criminal prosecution. The independent accountant shall justify any material departure from the "unqualified opinion" language as illustrated in Appendix 12.

The following Additional reports, which may be included in either the report of the financial audit or issued as separate reports, are recommended by GAAS and are also to be prepared and submitted. Samples of these reports are included in the Appendices.

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4. Auditor's Management Letter or Schedule of Findings and Questioned Costs. (See Appendix 13) When the auditor identifies an issue, the following information should be provided to HUD officials to permit timely and proper corrective action to be taken. The auditor should attempt to identify:
  - o condition (the nature of the problem)
  - o criteria (what the owner/management agent should be doing)
  - o effect (what happened as a result of the problem)
  - o cause (why the problem exists)

The findings reported by an auditor may serve as a basis for HUD to perform additional reviews.

The Auditor's "Management Letter or Schedule of Findings and Questioned Costs" should be attached to the auditor's report on compliance.

5. Auditor's Comments on Audit Resolution Matters. (See Appendix 13) This report identifies whether a project owner has taken corrective actions on findings from the prior audit report. The auditor should provide the project name, prior audit report number, a brief description of the finding and the status of the corrective action and the finding. This report also includes findings contained in program review reports, and state agency reports.
6. Auditee's Response or Corrective Action Plan. (See Appendix 13) The report should provide a statement of agreement or disagreement with the findings and the recommendations proposed. If the auditee disagrees with a finding, specific information should be provided as to why the finding is considered to be incorrect. The auditee should also provide

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detailed actions taken or planned to correct the deficiencies noted in the report.

C. COOPERATIVE'S (MORTGAGOR'S)  
CERTIFICATION.

The following certifications by two corporate officers of a cooperative corporation must accompany the report:

1. "The Books of Account are being maintained in accordance with the Uniform System of Accounts for Cooperative Housing Corporations as required by the Department of Housing and Urban Development".
2. "We hereby certify that we have examined the accompanying financial statements and supplemental data of (corporate name) and, to the best of our knowledge and belief, the same is complete and accurate".
3. The report also shall include the Employer Identification Number (EIN) assigned to the project by the Internal Revenue Service when the project is owned by a partnership or a corporation or any entity having an EIN. The EIN must be entered below the partner or corporate signatures.

D. STATEMENT OF OCCUPANCY DURING  
CONSTRUCTION OPERATIONS.

This statement covers the period of occupancy during construction and it must adhere to the requirements of HUD Handbook 4470.1, Mortgage Credit Analysis. This report must show gross Carrying Charges received (excluding actual operating expenses during the period, although in certain cases accrued expenses may be allowed).

1. Additional allowable operating expenses for this purpose may include:

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- a. advertising expense,
  - b. sales commissions customary for the type of project, if any,
  - c. a reasonable management fee (excluding salaries paid to officers of sponsor or mortgagor), and
  - d. electricity, gas, water and operating salaries (maintenance, cleaners, gardeners, elevator operators, etc.) to the extent they are not included in construction costs on Form HUD-92330 or Form HUD-92330-A.
2. Unallowable Expenses include the following Occupancy costs:
    - a. Depreciation
    - b. Interest
    - c. Taxes
    - d. Property Insurance Premiums
    - e. Mortgage Insurance Premiums (MIP)
  3. If this statement shows an excess of revenue over operating expenses, as defined, the excess shall be treated as a recovery of construction costs (line 15 of Form HUD-92330), except in nonprofit mortgagor cases.

- a. A copy of the statement, signed by the mortgagor, must be attached to Form HUD-92330.
- b. In nonprofit-mortgagor cases, net income is sometimes treated as a recovery of cost and sometimes transferred at final closing to a residual receipts account for future project

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needs (See Handbook 4470.1 and cost certification instructions). The income statement, however, must be reviewed to determine if any expense items shown in the statement were paid from Allowance to Make a Project Operational (AMPO) funds or otherwise included in cost certification items. If so, the net income reflected in the statement shall be adjusted accordingly; and a requirement made that such adjusted net income be transferred to the residual receipts accounts.

- 4. If operating expense exceeds revenue, no entry is made on Form HUD-92330. In this case, the recognized excess of expense over revenue may be carried over as a reduction of net income in any income statement required.

E. STATEMENT COVERING THE PERIOD BETWEEN COST CERTIFICATION CUTOFF DATE AND FIRST SCHEDULED PRINCIPAL PAYMENT. This statement is to be prepared according to the instructions contained in HUD Handbook 4470.1, Mortgage Credit Analysis.

F. MANAGING AGENT'S CERTIFICATION. In instances where there is a management agent for the project, a certification is required that shall identify the individual as well as the company for management. The Managing Agent's Certification should take the form of the Mortgagor's Certification.