FINANCIAL REPORTING UNDER THE NEW OPERATING FUND RULE
(Revised for Force Account April 16, 2008)

Reporting Brief 2: Capital Fund Program

The purpose of this brief is to illustrate the reporting of Capital Fund activity under asset management, based on the proposed changes to the Financial Data Schedule (FDS).[1] In particular, this brief is designed to address the proper reporting on the FDS of the following:

1) Transfers to the Operating Fund
2) Management Improvements
3) Recognition of revenue (soft and hard)
4) Booking of management fee
5) Memo accounts
6) Force account labor and equipment purchases
7) Modernization coordinators
8) Modernization inspectors and construction supervisors
9) Replacement Housing Funds (RHF)

Sample PHA

For ease of illustration, we have created a fictitious PHA that has one high-rise project of 300 units. Other information on the PHA include:

- Amount of Capital Grant: $900,000
- Capital Grant Management Fee: $90,000 (10% of grant)
- Capital Fund Transfer to Operations: $180,000
- Management Improvements: $135,000 (used for on-site resident services)
- Capital Fund Audit Costs: $9,000 (represents reasonable allocation of overall agency audit to Capital Fund program).

Discussion

1.) Transfers to the Operating Fund

The PHA would reflect the $180,000 Transfer to Operations under FDS Line Item 10010, Operating Transfers In, within the Operating Fund column for this AMP. Within the

[1] See proposed FDS template, posted December 28, 2007 on asset management website at: http://www.hud.gov/offices/pih/programs/ph/am/fds.cfm.

Capital Fund Column, the PHA would record $180,000 in FDS Line Item 10020. These transactions are shown below.

Account Number	Description	AMP 1	Operating Fund Program	Capital Fund Program
10010	Operating transfer in	$180,000	$ 180,000	
10020	Operating transfer out	$ 180,000		$ 180,000

The Total AMP Income Statement column, which combines Operating and Capital Fund activity, is not affected by these transactions since the transfers (in/out) offset each other. Once transferred to "Operations", the "expenses" are not differentiated within the Operating Fund column from other expenses funded directly through Operating Fund.

2.) Management Improvements

Similar to the treatment of Operating Transfers, the PHA would expense the amounts spent on Management Improvements within the Operating Fund. These expenses are funded through a Transfer to the Operating Fund program as well.

Suppose the $135,000 Transfer for Management Improvements was spent on salaries for tenant services staff.[2] The PHA would show a Transfer Out, in the amount of $135,000, from the Capital Fund Program and a Transfer In, in the same amount, in the Operating Fund Program column. Presumably, if the PHA had no other expenses related to tenant services salaries, the amount on this line item would be $135,000; however, if the PHA had other project salaries for tenant services, one would not know that $135,000 was, in effect, funded through the Capital Fund Program (i.e., once funds are transferred, for purposes of identification on the FDS, they lose their identity).

Account	Description	AMP 1	Operating Fund Program	Capital Fund Program
10010	Operating transfer in	$ 135,000	$ 135,000	
10020	Operating transfer out	$ 135,000		$ 135,000

[2] Under the CFP, a PHA may spend up to 20% on Management Improvements. In this particular case, the PHA chose to spend 15%.

For simplicity of presentation, the above example isolates only the Management Improvement activity, i.e., the $135,000 Operating Transfer in (Management Improvements) and the $135,000 Operating Transfer out. In actuality, the PHA would report the cumulative transfers of $180,000 (previous example) and $135,000, for a combined transfer in/out of $315,000.

To the extent that Management Improvements are capitalized, these amounts would not be transferred out but would be recorded on the FDS in the capital Memo accounts, similar to any other capital item funded through the Capital Fund.

3.) Recognition of Revenue (soft and hard)

Historically, PHAs were required to distinguish Capital Fund revenues among "hard" and "soft" on the FDS. Amounts drawn down for hard costs are reported under Line Item 70610 while amounts for soft costs are reported under Line 70600. These basic reporting requirements do not change under asset management. What changes is that Capital Fund activity is now reported directly at the AMP level (there is no longer a separate Capital Fund program column on the FDS, with its own CFDA number).

Soft costs include: transfers to operations, management improvements, management fees, and audit costs. A/E fees, permits, testing, and other similar expenses directly related to a capital project that are capitalized would therefore be recognized as "hard" costs for revenue reporting purposes.

In addition to the $180,000 Transfer to Operations, and the $135,000 Transfer for Management Improvements, the sample PHA spends $90,000 on Management Fees and $9,000 for audit costs[3]. Consequently, the PHA has soft revenue of $ 414,000 and hard revenue of $ 486,000, as shown below.

[3] CFP proceeds may be reported as soft cost revenue expensed through the CFP column per account no. 91200, Auditing Fees. Since audit costs are allowable direct costs to the grant per OMB A-133, any portion of the audit cost applicable to CFP should be charged as an expense within the CFP AMP column. A "reasonable" allocation to this program and among AMPs is acceptable.

Account Number	Description	AMP 1	Operating Fund Program	Capital Fund Program
70600	**HUD PHA operating grants**	$ 414,000		$ 414,000

70610	**Capital grants**	$486,000		$ 486,000

Assuming the PHA expends only $470,000 of the Capital Grant proceeds received by fiscal year end, $ 16,000 is reported as:

Account # 342-020 Deferred Revenue – Capital Fund

Under this scenario, the following Journal Entries would be made to reflect the year-end financial position:

Debits:

Current Asset

112	Cash-restricted-modernization and development	$ 16,000

Fixed Asset:

167	Construction in progress	$ 470,000

Credits:

Revenue:

70610	Capital Grants	$ 470,000

Current Liability:

342 -020	Deferred revenue - Capital fund	$ 16,000

Revenues are reported when earned and measurable. Since Capital Fund revenues are considered earned when spent, any unpaid and/or non-incurred invoice at year-end is considered a deferred revenue liability. This situation would likely be rare, and any deferred revenue balances relatively small, as drawdown restrictions apply.

4.) Booking of Management Fee

The 10 percent Capital Fund Management Fee of $90,000 is expensed at the project level under the Capital Fund column, Line No. 91300. (Because this represents a fee-for-service, the COCC reports corresponding Management Fee revenues per Line No. 70710.)

5.) Memo Accounts

There are eight Capital Fund memo accounts. These memo accounts are intended to report the non-operating expenses of the Capital Fund program, i.e., capital expenditures, debt service payments, and RHF fund expenditures incurred during the reporting period. Based on the sample PHA, it would show $486,000 under Line No. 11620, Building Purchases. The total of these Capital Fund memo accounts and the Capital Fund operating expenses (including Transfers to Operations) should match the total revenue recognized under the Capital Fund.

New Numbering	Description	AMP 1	Operating Fund Program	Capital Fund Program
11610	Land Purchases			
11620	Building Purchases	$ 486,000		$486,000
11630	Furniture & Equipment-Dwelling Purchases			
11640	Furniture & Equipment-Administrative Purchases			
11650	Leasehold Improvements Purchases			
11660	Infrastructure Purchases			
13510	CFFP Debt Service Payments			
13901	Replacement Housing Factor Funds			

6.) Force Account Labor and Equipment Purchases

Note: Force Account, in the context of the Capital Fund, refers to labor performed directly by the PHA.

Non-Capitalized Force Account Labor

To the extent that Force Account Labor is used to support an operating activity, it should be funded through Transfers (Operating and/or Management Improvement) to the Operating Fund. In this instance, when an AMP-or COCC assigned Force Account employee performs non-capitalized labor at an AMP, the cost may be charged directly to the applicable expense account within the AMP.

94100	Ordinary maintenance and operations - labor

Capitalized Force Account Labor

In the case of force account labor used to support a capitalized activity, the following general rules apply:

- The work activity must be in the Annual Plan.
- Except for High Performer PHAs under the Public Housing Assessment System (PHAS), HUD approval is required for use of force account labor.
- All expenses must be documented.
- PHAs should prepare a budget for each job and routinely compare budgeted with actual expenses.
- The PHA should not charge a fee-for-service
    - PHAs can only charge actual costs of the work, including actual labor rates and fringe (a reasonable burdened rate).
    - A PHA cannot charge an overhead fee (the PHA already receives a Capital Fund management fee); however, the PHA can charge for direct cost of supervision of the job/work activity.
    - All relevant OMB Circular A-87 cost principles apply
- If the PHA is carrying out "capital-type" work, the PHA will capitalize the labor as part of the work placed in service.

The accounting affect of capitalized force account labor is essentially that the cost of such labor is capitalized (becomes a cost component of the balance sheet asset placed into service). Force account labor results in a debit to a fixed asset account in the amount of the approved capital improvement related work performed. For instance, see the general example below:

AMP

- Debit -Fixed Asset $ 1,000
- Credit Capital Fund Revenue: $ 1,000

Equipment purchases and Force Account labor

Assume an AMP has a desktop computer capitalization threshold of $ 2,500. The AMP may expense a computer costing $2,400 directly. This expense may be charged for instance, as Other Operating-Administrative, General Expense or Office Expense.

On the other hand, a computer costing $ 2,600 is capitalized. For instance, the AMP recognizes capital grants revenue in this amount, but rather than reporting an expense, the AMP books the $ 2,600 to a capital asset account, i.e. Furniture & Equipment

Capitalization of the Asset

A computer may be capitalized by the actual cost and any make ready costs incurred, which in total, meet or exceed the capitalization threshold. For instance, a computer with a $2,525 cost basis ($2,450 cost + $75 make ready cost)has an initial impact on the balance sheet of $ 2,525; less any depreciation amortized during the reporting period subsequent to date of acquisition. The capitalized computer would likely be booked to the following account:

164	Furniture, equipment and machinery – administration

Example:

- June 30 PHA
- 5-year depreciation schedule, no salvage value
- $ 2,525 computer purchased on 7-1-07
- $2,525/5 yrs = $ 505 annual depreciation expense.

- 6-30-08 Book value of computer:
  - Original capitalized amount: $ 2,525
  - Less: Accumulated Depreciation: $ 505
  - Net book value: Computer: $ 2,020

Since the balance sheets of the CFP and operating fund are combined, the $ 2,020 fixed asset would appear, in account no.164 with a net book value of $ 2,020 within the "Total AMPs" balance sheet column at year-end. Regarding depreciation recognition, this may or may not be recognized within the CFP column, depending on the policy of the PHA. Many PHAs retain only construction in progress assets and transfer completed fixed assets to the operating fund.

7.) Modernization Coordinators

If the agency employs a "Modernization Coordinator", i.e., an individual(s) responsible for the overall program coordination, including the preparation of Capital Fund plans and program reports, this position is funded through the Capital Fund management fee.

In other words, the costs of the modernization coordinator would not appear on the Income Statement of the AMP but on the Income Statement of the COCC.

Small PHAs not converting to asset management would report the modernization coordinator salary as a direct expense to the Capital Fund program.

8.) PHA Modernization Inspectors and Construction Supervisors

In contrast to the modernization coordinator, a PHA can charge to each project (i.e., a capitalized expense) the cost of modernization inspectors/construction supervisors. The memo section of the FDS will reflect the capitalized cost of the modernization inspector's documented inspection work associated with modernization of an AMP. The modernization inspector contributes to the capitalized cost of the modernization work underway. Typically, the documented cost associated with this inspector is capitalized to a work in progress (i.e. building) account.

Assuming that the cost associated with the Modernization Inspector's work at a particular AMP during August of 2007 is $1,000, the following journal entries are made on August 31, 2007:

- Debit Cash-restricted. Modernization and development: $1,000
- Credit: Cash-restricted. Modernization and development: $1,000

- Debit: Construction in Progress: $1,000
- Credit: Capital Fund revenue: $1,000

The above is a limited illustration of accounting activities. It ignores the fact that the Capital Fund program realizes the revenue associated with the capitalized costs on a periodic basis, upon completion of the associated facet of work.

9.) Replacement Housing Funds (RHF)

RHF proceeds may be reported within either an Other AMP column, or an existing AMP column as circumstances may warrant. For instance, an AMP undergoing demolition with an active number in PIC, would report the demolition grant proceeds, and any associated costs within that AMP column. Conversely, a new development, not yet assigned a number in PIC, would be reported in the Other AMP column.

To the extent that an existing AMP is undergoing demolition, and a new building planned at the existing site, the demolition, and construction activities are both reported within the particular AMP column, as designated in PIC.