Public Housing Assessment System (PHAS) - Interim Rule

Financial Condition Indicator

June 6, 2011
Financial Assessment Subsystem (FASS): Areas To Be Covered

- **Asset Management**: A brief overview
- **Prior vs. New FASS Sub-Indicators**: Compare & Contrast
- **New FASS Sub-Indicators**: What are they? What do they mean?
- **FASS Scoring Process**: Tiers: 1, 2, 3
Asset Management

Implemented for PHAs beginning with FYE of 06/30/2008

PHAs account for activities by projects. PHAs report to FASS-PH on a project level as well as on an entity-wide basis

Low Rent and Capital Fund program (CFP) activities are reported at the project level

All other programs and activities (entity-wide) are reported on separate columns on the Financial Data Schedule (FDS)
Projects report Low Rent and Capital Fund program activities at a **project level**

**Each project** will be assessed based on the combination of the Capital Fund and Low Rent programs.

**Each project** will receive a Financial Condition Indicator score based on the three (3) new sub-indicators (ratios).

PHAs will also receive a weighted average Financial Condition Indicator score **based on the weighted average score for each project**.
### Interim PHAS Score by Indicator

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Points</th>
</tr>
</thead>
<tbody>
<tr>
<td>Physical Condition</td>
<td>40</td>
</tr>
<tr>
<td>Financial Condition *</td>
<td>25</td>
</tr>
<tr>
<td>Management Operations</td>
<td>25</td>
</tr>
<tr>
<td>Capital Fund Program</td>
<td>10</td>
</tr>
<tr>
<td><strong>Overall PHAS score</strong></td>
<td>100</td>
</tr>
</tbody>
</table>

* Threshold score for this indicator must be at least 15 points, or 60% of maximum number of points (25).
## Prior vs. New Sub-indicators (Ratios)

### Prior PHAS

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Ratio</td>
<td>9.0</td>
</tr>
<tr>
<td>Months Expendable Fund Balance (MEFB)</td>
<td>9.0</td>
</tr>
<tr>
<td>Tenant Receivables Outstanding (TRO)</td>
<td>4.5</td>
</tr>
<tr>
<td>Occupancy Loss (OL)</td>
<td>4.5</td>
</tr>
<tr>
<td>Net Income (NI)</td>
<td>1.5</td>
</tr>
<tr>
<td>Expense Management (EM)</td>
<td>1.5</td>
</tr>
<tr>
<td><strong>TOTAL POINTS</strong></td>
<td><strong>30.0</strong></td>
</tr>
</tbody>
</table>

### Interim PHAS

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quick Ratio (QR)</td>
<td>12.0</td>
</tr>
<tr>
<td>Months Expendable Net Assets Ratio (MENAR)</td>
<td>11.0</td>
</tr>
<tr>
<td>Debt Service Coverage Ratio (DSCR)</td>
<td>2.0</td>
</tr>
<tr>
<td><strong>TOTAL POINTS</strong></td>
<td><strong>25.0</strong></td>
</tr>
</tbody>
</table>
New Ratios

**Quick Ratio (QR)**
- Measures liquidity
- Similar to Current Ratio (CR)
- Maximum 12 points

**Months Expendable Net Assets Ratio (MENAR)**
- Measures adequacy of reserves
- Similar to Months Expendable Fund Balance (MEFB) Ratio
- Maximum 11 points

**Debt Service Coverage Ratio (DSCR)**
- Measures capacity to cover debt
- New ratio
- Maximum 2 points
New Ratio Computations: QR

**NUMERATOR**

- **Cash**
  - FDS 111* Cash-Unrestricted
  - FDS 114 Cash Tenant Security Deposits
  - FDS 115 Cash Restricted for Payment of Current Liabilities

- **Cash Equivalent**
  - FDS 115 Cash Restricted for Payment of Current Liabilities

- **Current Receivables**
  - FDS 120 Total Receivables net of allowance for doubtful accounts
  - FDS 131 Investments Unrestricted
  - FDS 135 Investments Restricted for payment of current liability
  - FDS 142 Prepaid Expenses and Other Assets
  - FDS 144 Inter-program-due-from

**DENOMINATOR**

- **Current Liabilities**
  - FDS 310 Total Current Liabilities
  - [343-010] CFFP Current Portion of long-term debt capital projects/mortgage revenue bonds

*Henceforth, FDS##### refers to FDS line items*
How QR is Scored

- **QR < 1.0**: 0 points
- **QR = 1.0**: 7.2 points
- **1.0 < QR < 2.0**: 7.2 < points < 12.0
- **QR ≥ 2.0**: 12.0 points
New Ratio Computations: MENAR

**Numerador**

- **Unrestricted Resources**
  - **Cash**
    - **FDS 111** Cash-Unrestricted
  - **FDS 114** Cash Tenant Security Deposits
  - **FDS 115** Cash Restricted for Payment of Current Liabilities

- **Cash Equivalent**
  - **FDS 120** Total Receivables net of allowance for doubtful accounts
  - **FDS 130** Total Receivables net of allowance for doubtful accounts

- **Current Receivables**
  - **FDS 131** Investments Unrestricted
  - **FDS 135** Investments Restricted for payment of current liability
  - **FDS 142** Prepaid Expenses and Other Assets
  - **FDS 144** Inter-program-due-from

**Denominador**

- Average Monthly Operating Expenses
  - **FDS 96900** Total Operating Expenses
  - **FDS 97100** Extraordinary Maintenance
  - **FDS 97200** Casualty Loss Non-capitalized
  - **FDS 97800** Dwelling Units Rent Expense

\[
\text{Average Monthly Operating Expenses} = \left( \frac{FDS 96900 + FDS 97100 + FDS 97200 + FDS 97800}{12} \right)
\]
How MENAR is Scored

- **MENAR < 1.0**: 0 points
- **MENAR = 1.0**: 6.6 points
- **1.0 < MENAR < 4.0**: 6.6 < points < 11.0
- **MENAR ≥ 4.0**: 11.0 points
New Ratio Computations: Debt Service Coverage Ratio (DSCR)

**NUMERATOR**

Adjusted Operating Income

- FDS 97000 Excess Operating Revenue over Operating Expenses
- FDS 96700 Interest Expense and Amortization Costs

**DENOMINATOR**

Annual Debt Service excluding CFFP debt

- FDS 96710 Interest on Mortgage (or bonds) payable
- FDS 96720 Interest on notes payable (short- & long-term)
- FDS 11020 Required Annual Debt Principal Payments
How DSCR is scored

- **DSCR < 1.0**: 0 points
- **≥ 1.0 but < 1.25**: 1 point
- **DSCR ≥ 1.25**: 2 points
- **NO DEBT AT ALL**: 2 points
FASS-PH Scoring Process

Score Adjustments

- Timeliness of Submission
  - Late Penalties
  - Late Presumptive Failure
- Audit Adjustments
  - Audit Flags
  - Significant Change Penalty
Timeliness of Submission

Unaudited
- Due 2 months after PHA’s FYE; 1 penalty point for every 15 days past due date

Audited
- After 90 days = LPF
- Due 9 months after PHA’s FYE; if late = LPF

Due 90 days = LPF
Types of Audit Flags

Flags

NEW FLAG:
Opinion(s) on Supplemental Information

Report on Internal Control and Compliance (Yellow Book)

Report on compliance with Requirements Applicable to Major Federal Programs (OMB Circular A-133)

Other Considerations

Financial Statement Audit Opinion(s)

NONE

TIER 1

TIER 2

NONE

TIER 1

TIER 2

TIER 3

TIER 1

TIER 2

TIER 1

TIER 2

TIER 3
Each tier assesses point deductions of varying severity

**Tier 1**
- Any Tier 1 finding assesses a 100 percent deduction of the PHA’s financial condition indicator score.

**Tier 2**
- Any Tier 2 finding assesses a point deduction equal to 10 percent of the unadjusted financial condition indicator score.

**Tier 3**
- Each Tier 3 finding assesses a 0.5 point deduction per occurrence, to a maximum of 4 points of the financial condition indicator score.

**Unqualified Opinion (no penalty)**
## Audit Flags and Tier Interactions

<table>
<thead>
<tr>
<th>Financial Statement Audit Opinion(s)</th>
<th>Categories</th>
<th>Tier Classification *</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Unqualified Opinion</td>
<td>None</td>
<td></td>
</tr>
<tr>
<td>2. Qualified Opinions</td>
<td>Tier 2</td>
<td></td>
</tr>
<tr>
<td>• Departures from GAAP not significant enough to cause adverse opinion(s)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Limitations on the scope of the audit (regardless of cause) not significant enough to cause a disclaimer of opinion</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Adverse Opinion(s) regardless of reason(s)</td>
<td>Tier 1</td>
<td></td>
</tr>
<tr>
<td>4. Disclaimer of Opinion(s) regardless of reason(s)</td>
<td>Tier 1</td>
<td></td>
</tr>
</tbody>
</table>

* Deduction only if the departure includes Low Rent or Capital Fund programs
## NEW: Opinion(s) on Supplemental Information [Statement of Auditing Standard (SAS) 117 “in relation to” type of opinion]*

<table>
<thead>
<tr>
<th>Categories</th>
<th>Tier Classification</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Fairly stated</td>
<td>None</td>
</tr>
<tr>
<td>2. Fairly stated except for:</td>
<td>Tier 2</td>
</tr>
<tr>
<td>3. No opinion</td>
<td>Tier 1</td>
</tr>
<tr>
<td>4. Incomplete or missing</td>
<td>Tier 1</td>
</tr>
</tbody>
</table>

* Applies to the FDS

## Report on Internal Control and Compliance and Other Matters Noted in an Audit of the Financial Statement performed in accordance with Government Auditing Standards (GAS) (Yellow Book)**

<table>
<thead>
<tr>
<th>Categories</th>
<th>Tier Classification</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Control Deficiencies</td>
<td>Tier 3</td>
</tr>
<tr>
<td>• Significant Deficiencies</td>
<td></td>
</tr>
<tr>
<td>• Material Weaknesses</td>
<td></td>
</tr>
<tr>
<td>2. Material noncompliance</td>
<td>Tier 3</td>
</tr>
<tr>
<td>3. Fraud (new)</td>
<td>Tier 3</td>
</tr>
<tr>
<td>4. Illegal Acts (new)</td>
<td>Tier 3</td>
</tr>
<tr>
<td>5. Abuse (new)</td>
<td>Tier 3</td>
</tr>
</tbody>
</table>

** Deduction applies only if it relates to Low Rent or Capital Fund programs
# Audit Flags and Tier Interactions

<table>
<thead>
<tr>
<th>Report on compliance with requirements applicable to major federal programs and internal control over compliance with OMB Circular A-133</th>
<th>Categories</th>
<th>Tier Classifications</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Opinion on compliance with each major federal program requirements</strong></td>
<td>1. Unqualified Opinion(s)*</td>
<td>None</td>
</tr>
<tr>
<td></td>
<td>2. Qualified Opinion(s)*(regardless of cause)</td>
<td>Tier 2</td>
</tr>
<tr>
<td></td>
<td>3. Adverse Opinion(s)*(regardless of cause)</td>
<td>Tier 1</td>
</tr>
<tr>
<td></td>
<td>4. Disclaimer of Opinion(s) *(regardless of cause)</td>
<td>Tier 1</td>
</tr>
</tbody>
</table>
| **Internal controls and compliance** | 1. Control deficiencies in internal controls  
  • Significant deficiencies (over compliance)**  
  • Material weaknesses (over compliance)** | Tier 3 |
|  | 2. Material noncompliance** | Tier 3 |

*On compliance with Low Rent program and Capital Fund program major federal requirements

** Regarding Low Rent program and Capital Fund program requirements
## Audit Flags and Tier Interactions

<table>
<thead>
<tr>
<th>Other Considerations</th>
<th>Categories</th>
<th>Tier Classification</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1. Significant change penalty deduction applies only if the significant change(s) relates to the Low Rent or Capital Fund programs</td>
<td>Tier 2</td>
</tr>
<tr>
<td></td>
<td>2. Going concern</td>
<td>Tier 1</td>
</tr>
<tr>
<td></td>
<td>3. <strong>Management Discussion and Analysis and other supplemental information omitted</strong> (new)</td>
<td>Tier 2</td>
</tr>
<tr>
<td></td>
<td>4. Financial statements using basis other than GAAP</td>
<td>Tier 1</td>
</tr>
</tbody>
</table>
Significant Change Penalty

A penalty will be assessed for significant differences between the unaudited and audited submissions.

A significant difference is considered to be an overall score decrease of 3+ points from unaudited to audited.

A Significant Change Penalty is considered a Tier 2 flag; therefore it will result in a 10% audited score reduction.
Summary: Point Values

Financial Condition Indicator

- Up to 25 points
- Threshold score is at least 15 points

3 New Sub-Indicators (Ratios):

- Quick Ratio (QR) - 12 points
- Months Expendable Net Assets Ratio (MENAR) - 11 points
- Debt Service Coverage Ratio (DSCR) - 2 points
Summary: Subtracting Points

Late Penalties and Late Presumptive Failure

- Same as prior PHAS

Audit Flags each based on a 3 tier classification system

- Tier 1: 100% deduction from FASS score
- Tier 2: 10% deduction of unadjusted FASS score
- Tier 3: 0.5 point deduction per occurrence of up to 4 points of the FASS score

Significant Change Penalty

- Difference between unaudited and audited submissions
- Tier 2 Flag → 10% deduction
FASS Resources & Contacts

• Financial Assessment Subsystem-PH webpage
  http://www.hud.gov/offices/reac/products/prodpha.cfm

• FASS-PH team
  http://www.hud.gov/offices/reac/products/fass/pha_team.cfm

• Technical Assistance Center (TAC)
  (7:00 am-8:30 p.m., EST, M-F)
  1(888)245-4860
  REAC_TAC@hud.gov