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PROGRAM GUIDANCE

FOR: All Tribal Government Leaders and Tribally Designated Housing Entities (TDHE)

R.B.A.

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TOPIC: Conversion to and Implementation of Generally Accepted Accounting Principles

PURPOSE: The purpose of this guidance is to:

- Inform tribes and tribally designated housing entities (TDHE) of the program requirements for implementing Generally Accepted Accounting Principles (GAAP);
- Identify the various resources available to assist in the conversion and implementation of GAAP;
- Provide an overview of the GAAP hierarchy;
- Present the benefits of converting to GAAP; and
- Convey answers to the most frequently asked questions regarding implementation of GAAP.

BACKGROUND: The Inspector General's (IG's) report titled, "Nationwide Audit of Implementation of the Native American Housing Assistance and Self-Determination Act (NAHASDA) of 1996," issued on August 2, 2001, included a finding relating to housing entities that do not submit reports required by the Single Audit Act or use uniform accounting standards for all financial statement elements. The IG found that housing entities prepared external financial statements based on differing accounting standards. As a result, HUD has no basis for evaluating and comparing their financial condition.

In response to this, the Office of Native American Programs (ONAP) is issuing guidance for tribes' and TDHEs' accounting staff, independent auditors, fee accountants and other interested accounting professionals on the conversion to and implementation of GAAP.

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PROGRAM REQUIREMENTS:

Following are citations regarding requirements for the use of GAAP in the programs for which tribes and TDHEs are eligible. These programs include, but are not limited to, Indian Housing Block Grant (IHBG), Indian Community Development Block Grant (ICDBG), Indian Housing Drug Elimination Program (IHDEP), Rural Housing and Economic Development (RHED) and Resident Opportunities and Self-Sufficiency (ROSS).

OMB Circular A-133: This Circular requires recipients to obtain annual audits if they expend \$300,000 or more in Federal funds in a Fiscal Year (FY). Additionally, paragraph 505(a) of this circular states: *“An opinion (or disclaimer of opinion) as to whether the financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles and an opinion (or disclaimer of opinion) as to whether the schedule of expenditures of Federal awards is presented fairly in all material respects in relation to the financial statements taken as a whole.”*

OMB Circular A-87: Item 1.g. of Attachment A, Paragraph C, Factors affecting allowability of costs, states: *“To be allowable under Federal awards, costs must meet the following general criteria: ...Except as otherwise provided for in this Circular, be determined in accordance with generally accepted accounting principles.”*

Title 24 CFR 85: Part 85.26, Non-federal Audits, states: *“Grantees and sub-grantees are responsible for obtaining audits in accordance with the Single Audit Act Amendments of 1996 (31 U.S.C. 7501-7507) and revised OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations.”*

GAAP HIERARCHY:

The GAAP hierarchy for state and local governments, including special purpose entities such as TDHEs, is set forth in the auditing standards of the American Institute of Certified Public Accountants (AICPA) Professional Standards Section AU-411, paragraph 12. The standards provide this hierarchy for GAAP as follows:

- a) Category (a), officially established accounting principles, consists of Governmental Accounting Standards Board (GASB) Statements and Interpretations, as well as AICPA and Financial Accounting Standards Board (FASB) pronouncements specifically made applicable to state and local governmental entities by GASB Statements or Interpretations. GASB Statements and Interpretations are periodically incorporated in the Codification of Governmental Accounting and Financial Reporting Standards.
- b) Category (b) consists of GASB Technical Bulletins and, if specifically made applicable to state and local governmental entities by the AICPA and cleared by the GASB, AICPA Industry Audit and Accounting Guides and AICPA Statements of Position.
- c) Category (c) consists of AICPA Accounting Standards Executive Committee Practice Bulletins if specifically made applicable to state and local governmental entities and cleared by the

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GASB, as well as accountant consensus positions organized by the GASB that attempts to reach agreement on accounting issues applicable to state and local governmental entities.

- d) Category (d) includes implementation guides “Qs and As” published by the GASB staff, as well as practices that are widely recognized and prevalent in state and local governments.

In addition, the following documents are available to assist tribes and TDHEs in converting to GAAP. They can be located at the following sources:

- GASB statements, interpretations, technical bulletins and implementation guides can be purchased on the web at <http://www.gasb.org/pub/index.html>.
- FASB pronouncements specifically made applicable to state and local governmental entities by GASB statements or interpretations can be purchased on the Internet at <http://store.yahoo.com/fasbpubs/>.
- The AICPA Industry Audit and Accounting Guide for Audits of State and Local Governments and AICPA Statements of Position can be obtained on the Internet at https://www.cpa2biz.com/CS2000/Products/store.htm?cs_catalog=CPA2Biz.
- The Native American Finance Officers Association developed the New Financial Reporting Model for Tribal Governments that implements GASB Statement 34. This document can be ordered on the Internet at www.nafoa.org or by calling (920) 869-7172.
- PIH Notices 2002-17 (TDHEs) issued June 28, 2002, *Financial Audit Requirements*, and 2003-6 (TDHEs) issued February 19, 2003, *Applicability of GAAP to ONAP Grantees*, contain specific guidance regarding the financial audit requirements for participants in the IHBG, ICDBG and other grant programs administered by ONAP. Copies of PIH Notices are located at <http://www.hudclips.org/subscriber/cgi/legis.cgi>.
- *Choosing an External Auditor, Guide for Making a Sound Decision*, dated March 2000, can be obtained at <http://www.state.me.us/education/edletrs/2001/ilet/i25autitorguide.rtf>.
- Program Guidance developed by the ONAP to inform Program recipients of various Program issues can be located at <http://www.codetalk.fed.us/> or by contacting your Area ONAP.
- The HUD Real Estate Assessment Center (REAC) has developed guidance on a number of GAAP related topics that may also apply to tribes and TDHEs. They issue guidance in their *GAAP Flyers and Accounting Briefs*, which can be found on the Internet at <http://www.hud.gov/offices/reac/products/prodpha.cfm>.

BENEFITS:

Benefits to the tribe and TDHE of converting to GAAP include:

- More accounting and audit personnel are willing to respond to a Request for Proposals (RFP) if the entity uses an accounting system that conforms to GAAP. In addition, program recipients have a wider variety of choices when hiring their accounting staff.
- The former HUD basis of accounting, required under the U.S. Housing Act of 1937 ('37 Housing Act) programs, is no longer considered to be a “comprehensive basis of accounting other than generally accepted accounting principles.” Preparation of financial statements using the former HUD accounting system could result in an auditor placing an adverse opinion on the financial statements when conducting an audit required by the Single Audit Act. Use of GAAP would remedy this situation.

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- Third party readers of the financial statements (Federal government representatives, bankers, lenders, non-profit organizations, and tribal constituency) better understand and place greater reliance on financial statements that have been prepared according to GAAP. Additionally, such users also place greater reliance on financial statements that have an unqualified opinion than those having a qualified opinion. Entities having a qualified opinion may be requested to provide additional information and statements to support their financial position.
- Conformance to GAAP alleviates possible imposition of sanctions based upon Section 401 of NAHASDA for failure to comply with the requirements of OMB Circulars A-87 and A-133.

QUESTIONS AND ANSWERS:

The first issuance of GAAP Questions and Answers is included in this guidance. Topics covered in this guidance include: General Information, Financial Reporting Entity, HUD-Guaranteed Debt, Lease-to-own Homeownership, Compensated Absences and Uncollectible Accounts. These Questions and Answers will be updated periodically in future Program Guidances and sent to all tribes and TDHEs.

SUMMARY:

The process of converting to GAAP should be a joint effort between the tribe or TDHE and their accounting and auditing professionals. The Department suggests that you begin the conversion process at the start of your FY with the goal of producing year-end financial statements that have been prepared according to GAAP.

If we may be of further assistance, please contact your Area ONAP.

QUESTIONS AND ANSWERS

GENERAL INFORMATION

Question: What method of accounting should a tribe or TDHE choose when implementing GAAP?

Answer: Recipients of ONAP's program funding may choose one of two methods:

Governmental Model and the Modified Accrual Basis of Accounting. This method is a fund account used to assist governmental entities in achieving fiscal accountability. However, it does not address operational accountability.

Enterprise Model and the Full Accrual Basis of Accounting. The Enterprise method provides an emphasis on business-type activities, financial statements and is similar to private sector financial statements, e.g., Statement of Net Assets, Statement of Revenues, Expenses, and Changes in Net Assets, and Statement of Cash Flows. This method is recommended to tribes and TDHEs due to the nature of housing and related business activities they conduct.

FINANCIAL REPORTING ENTITY

Question: What does the term "primary government" in GASB Statement Number 14 mean?

Answer: The term "primary government" refers to any state and general purpose local government (e.g., tribal government) and any special purpose entity that meets all of the following: (1) has a separately elected governing body; (2) is legally separate, and (3) is fiscally independent. Depending on how the relationship with the tribe is structured, a TDHE is an example of a special purpose entity.

Question: How is a special purpose entity deemed fiscally independent?

Answer: A special purpose entity is fiscally independent if it has the authority to do all three of the following: (1) determine its budget without modification from another governmental entity; (2) levy taxes or set its rates or charges, and (3) issue bonded debt without the approval of a primary government.

Question: What is the definition of a "financial reporting entity?"

Answer: Statement Number 14 of GASB states, "The definition of the reporting entity is based primarily on the notion of financial accountability. A primary government is financially accountable for the organizations that make up its legal entity. It is also financially accountable for legally separate organizations if its (primary government) officials appoint a voting majority of an organization's governing body and either it is able to impose its will on that organization or there is a potential for the organization to provide specific financial benefits to, or to impose specific financial burdens on, the primary government. A primary government may also be financially accountable for governmental organizations that are fiscally dependent on it."

Question: What does a financial reporting entity consist of?

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Answer: Statement Number 14 of GASB states “The financial reporting entity consists of (a) the primary government, (b) organizations for which the primary government is financially accountable, and (c) other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity’s financial statements to be misleading or incomplete.”

The organizations included with a primary government in the financial reporting entity are called component units. Statement Number 39 of GASB amended Statement Number 14 by providing additional guidance in determining whether certain organizations for which the primary government is not financially accountable should be reported as component units based on the nature and significance of their relationship with the primary government. Generally, it requires that an organization that raises and holds economic resources for the direct benefit of a governmental entity report as a component unit.

Question: How is the financial information of a component unit and that of the primary government combined for the financial reporting entity?

Answer: The component unit’s financial information will be displayed either discretely or blended with that of the primary government.

Question: How does one know if the component information should be displayed discretely or blended?

Answer: A reproduction of the GASB Statement Number 14 chart is attached to assist in making that decision. Consult with your accounting professional for detailed information.

HUD-GUARANTEED DEBT

Question: What is “conduit debt?”

Answer: The GASB Interpretation Number 2 defines conduit debt obligation as “certain limited obligation, revenue bonds, certificates of participation, or similar debt instruments issued by a state or local governmental entity for the express purpose of providing capital financing for a specific third party that is not part of the issuer’s reporting entity. Although conduit debt obligations bear the name of the governmental issue, the issuer has no obligation for such debt beyond the resources provided by a lease or loan with the third party on whose behalf they are issued.”

Question: What is an example of conduit debt?

Answer: An example of conduit debt is bonds issued in the name of a local County Development Authority for a tribe or TDHE.

Question: What is “HUD- guaranteed debt?”

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Answer: HUD-guaranteed debt is the financing mechanism used under the '37 Housing Act for the Indian housing programs. The HUD-guaranteed debt was either bond-financed, Federal Financing Bank notes or HUD-held debt.

Question: What is the status of the HUD-guaranteed debt?

Answer: Under the authority granted in the Housing and Community Development Reconciliation Amendments of 1985, the Secretary of HUD forgave outstanding principal and interest on certain HUD-held debt originally financed through an ACC.

Question: Were the Federal Financing Bank notes and bond-financed debt also forgiven?

Answer: No. Notice PIH 87-12, which implemented the debt forgiveness provisions of the Housing and Community Development Reconciliation Amendments of 1985, provides that "Forgiveness is limited to loans held by HUD which were to be repaid using annual contributions. Forgiveness does not extend to debt financing through the sale of Bonds...."

Attachment I, Section 1 (C) of Part B of the Consolidated Annual Contributions Contract (ACC) provides that "The forgiveness provided under Section 4 (c) is limited to loans held by HUD, repayment of which was to be made using annual contributions and does not extend to indebtedness of HAs to holders of bonds or notes sold to the Federal Financing Bank... ."

Question: How should you account for the Federal Financing Bank notes and bond-financed debt under GAAP?

Answer: Question 32 of the IHBG Program—Revised Notice of Transition Requirements, published in the Federal Register on January 27, 1998, is as follows:

Question 32. Can HUD continue funding for bond-financed projects in which the bonds were secured by ACCs?

Answer 32. Section 507 of NAHASDA addresses bond-financed projects. Annual contributions can be made by HUD, consistent with Section 507, to continue payments to trustees on behalf of holders of bonds issued, and outstanding, in connection with the development of Indian housing projects.

Section 507 of NAHASDA states:

- (a) **EXISTING RIGHTS AND DUTIES** – Except as provided in sections 502 and 503, this Act may not be construed to affect the validity of any right, duty, or obligation of the United States or other person arising under or pursuant to any commitment or agreement lawfully entered into before October 1, 1997, under the United States Housing Act of 1937, subtitle D of title IV of the Cranston-Gonzalez National Affordable Housing Act, title II of the Cranston-Gonzalez National Affordable

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Housing Act, title IV of the Stewart B. McKinney Homeless Assistance Act, or section 2 of the HUD Demonstration Act of 1993.

(b) OBLIGATIONS UNDER REPEALED PROVISIONS – Notwithstanding the amendments made by this title, any obligation of the Secretary made under or pursuant to subtitle D of title IV of the Cranston-Gonzalez National Affordable Housing Act, title II of the Cranston-Gonzalez National Affordable Housing Act, title IV of the Stewart B. McKinney Homeless Assistance Act, or section 2 of the HUD Demonstration Act of 1993 shall continue to be governed by the provisions of such Acts (as in effect before the date of the effectiveness of the amendments made by this title).

HUD made a regulatory commitment to continue making the principal and payments on interest on the behalf of the housing entities, and HUD is carrying that obligation on their financial records. Therefore, it is ONAP's position that those entities using the enterprise basis of accounting and those using the governmental model that have already implemented GASB Statement Number 34 should reclassify the Federal Financing bank notes or bond-financed debt as contributed capital. For those using the governmental model and the modified accrual basis of accounting that have not yet implemented GASB Statement No. 34, the debt would be removed from the General Long-Term Debt Account Group. We recommend that tribes and TDHEs meet with their auditors to address the appropriate accounting according to the specifics of their ACC.

LEASE-TO-OWN HOMEOWNERSHIP

Question: What is a "Capital Lease?"

Answer: A capital lease is a transaction in which the Lessee obtains significant property rights. Although *not* legally a purchase, *Theoretical Substance* governs over legal form and requires that the leased property be recorded as an asset on the lessee's books. A capital lease exists if any one of the following four criteria is met: (1) the lease transfers ownership of the property to the lessee at the end of the lease term; (2) a bargain purchase option exists; (3) the lease term is 75% or more of the life of the property; and (4) the present value of minimum lease payments equals or exceeds 90% of the fair value of the property.

Question: What is a "sales type lease" or "direct financing lease?"

Answer: The sales type lease and the direct financing lease are methods the Lessor uses to classify a capital lease. If the Lessor is the manufacturer or dealer in the item, then the transaction is given the term "sales type lease."

If the Lessor is not the manufacturer or the dealer of the item, then the transaction is called a direct financing lease. For the transaction to be termed either a sales type lease or direct financing lease the following criteria must be satisfied: (1) collectibility of minimum lease payments is predictable, and (2) no important uncertainties surround the amount of un-reimbursable costs yet to be incurred. The transaction gives rise to a profit or loss on the assumed sale of the item in the year of lease as well as

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interest income over the life of the lease. Lease payments receivable is recorded representing the minimum lease payments (net of amounts, if any, including executory costs with any profit thereon) plus the un-guaranteed residual value accruing to the benefit of the Lessor.

The difference between lease payments receivable and the discounted value of the payments is recorded as unearned interest income. The Mutual Help Homeownership Program as designed under the '37 Housing Act is very similar to a direct financing lease. However, the Mutual Help Program does not satisfy the criteria that the collectibility of minimum lease payments is predictable.

Question: How should the lease-to-own arrangement of the Mutual Help Homeownership Program be valued on a tribe's or TDHE's financial books?

Answer: The lease-to-own arrangement between the homebuyer and the tribe or the TDHE can best be described as a "lay away program." The housing units are maintained on the financial books in an inventory account until the unit is conveyed to the homebuyer. The value of the housing unit in the inventory account would be the lower of cost or market. The Mutual Help and Occupancy Agreement (MHOA) would establish the unit's purchase price or market price.

Question: How should you account for the funds collected from a homebuyer in the financial records?

Answer: The administrative fee is a reimbursement of the Mutual Help Program's operating expense; therefore these funds would be the tribe's or TDHE's operating income. The MHOA provides that when the homebuyer's monthly payment amount exceeds the administrative fee, the balance is transferred to the homebuyer's equity account. Mutual Help Equity Payment Account (MEPA) or Voluntary Equity Payment Account (VEPA) funds can be used to pay several things: unpaid monthly charges; charges made by the housing entity for completed maintenance work (which are the responsibility of the homebuyer); charges for unit improvements requested by the homebuyer and approved by the housing entity, and the balance of the purchase price.

Question: What should you do with MEPA or VEPA fund balances at the end of the MHOA period?

Answer: MEPA or VEPA balances should first be applied to a homebuyer's outstanding debt, such as the remaining purchase price and maintenance costs or housing improvement costs due the housing entity. Any remaining funds should be returned to the homebuyer as excess equity payments.

Question: How should you account for a lease-to-purchase program established under NAHASDA in the financial records?

Answer: It depends on the structure of the lease-to-purchase program. If the program follows the structure of the Mutual Help Homeownership Program established under the '37 Housing Act, then it may be accounted for in the manner previously described. The tribe or TDHE has the ability to establish a lease-to-purchase program similar to the Mutual Help Homeownership Program, but it must follow the requirements of NAHASDA. For example, the maximum rent or homebuyer payment requirement of NAHASDA §203(2), which states that the payment may not exceed 30% of the monthly-adjusted income of the family. The tribe or TDHE should consult with their professional

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accounting consultant to determine the proper accounting procedure for their particular lease-to-purchase program.

COMPENSATED ABSENCES

Question: What are “compensated absences?”

Answer: Statement Number 16 issued by GASB defines compensated absences as those absences for which “services have already been rendered and that are not contingent on a specific event that is outside the control of the employer and employee.” Vacation and sick leave are the two most common examples.

Question: How should entities that use the Enterprise method account for compensated absences?

Answer: Vacation leave and sick leave should only be accrued as a liability if it is attributable to past service and it’s probable that the employee will be compensated with time off, or with cash at termination or retirement.

Question: Is a compensated absence an eligible program expense chargeable to Federal grant programs?

Answer: Yes. Office of Management and Budget (OMB) Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments*, states in Attachment B, paragraph 11.d.:

(2) The cost of fringe benefits in the form of regular compensation paid to employees during periods of authorized absences from the job, such as for annual leave, sick leave, holidays, court leave, military leave, and other similar benefits, are allowable if: (a) they are provided under established written policies; (b) the costs are equitably allocated to all related activities, including Federal awards; and, (c) the accounting basis (cash or accrual) selected for costing each type of leave is consistently followed by the governmental unit.

(3) When a governmental unit uses the cash basis of accounting, the cost of leave is recognized in the period that the leave is taken and paid for. Payments for unused leave when an employee retires or terminates employment are allowable in the year of payment provided they are allocated as a general administrative expense to all activities of the governmental unit or component.

(4) The accrual basis may be only used for those types of leave for which a liability as defined by GAAP exists when the leave is earned. When a governmental unit uses the accrual basis of accounting, in accordance with GAAP, allowable leave costs are the lesser of the amount accrued or funded.

Question: How can the compensated absences, an accrued expense account, be charged to a Federal grant at the end of the grant term?

Answer: There are several options for doing this:

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- Draw down grant funds for compensated absences when the expense is actually paid. An accrued but unpaid compensated absence becomes the responsibility of the recipient at the time of grant closure. Use of non-federal funds to reimburse the account is necessary. Forecast this cost and treat as a contribution or as a match to the Federal grant funds.
- Develop a policy such as “use it or lose it.” In other words, at the end of the year, pay the employee for the balance of the accrued compensated absence balance and begin the year with a zero balance. These costs would then be charged to the grant. If grant funds were not sufficient, the amount for compensated absences would be the recipient’s responsibility. Again, use non-federal funds to cover the amount.
- Develop an indirect cost program wherein all compensated absences are included in the indirect cost pool. As the indirect cost rate is applied to all Programs, the recipient would be funded for all employees.
- Pay the employee for compensated absences as the leave is earned. A pay-as-you-go-program. Under this option, an employee does not have a leave balance at any time and there would not be an account for compensated absences.

Question: How should accrued compensated absences under governmental fund accounting be presented?

Answer: Governmental fund accounting uses a modified accrual accounting basis, the purpose of which is to measure flows of current financial resources in governmental fund financial statements. Liabilities that governments normally pay in a timely manner and in full from current financial resources (e.g., salaries and utilities) should be recognized when incurred, without regard to the extent to which resources are available to liquidate the liability. A government’s un-matured long-term indebtedness should be reported as general long-term liabilities, rather than governmental fund liabilities. This requirement applies not only to formal debt issues, such as bonds, but also to other forms of general long-term indebtedness, including compensated absences. A compensated absences liability that will be paid with current financial resources should be recognized as governmental fund liabilities in the current period. That portion of the compensated absences that will not be paid in the current period should be reported in the General Long-Term Debt Account Group. Additional guidance may be found in GASB Interpretation Number 6 titled *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*.

UNCOLLECTIBLE ACCOUNTS

Question: What are “uncollectible accounts”?

Answer: Uncollectible accounts are those accounts receivable, notes receivable or other types of receivables for which the housing entity will not receive payments. Examples of uncollectable accounts are tenants who have declared bankruptcy or are on the verge of default.

Question: Can an uncollectible account be written off as a bad debt and charged to a Federal grant program?

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Answer: No. OMB Circular A-87, in Attachment B, paragraph 7, states, “Any losses arising from uncollectible accounts and other claims, and related costs are unallowable unless they are provided for in Federal program award regulations.”

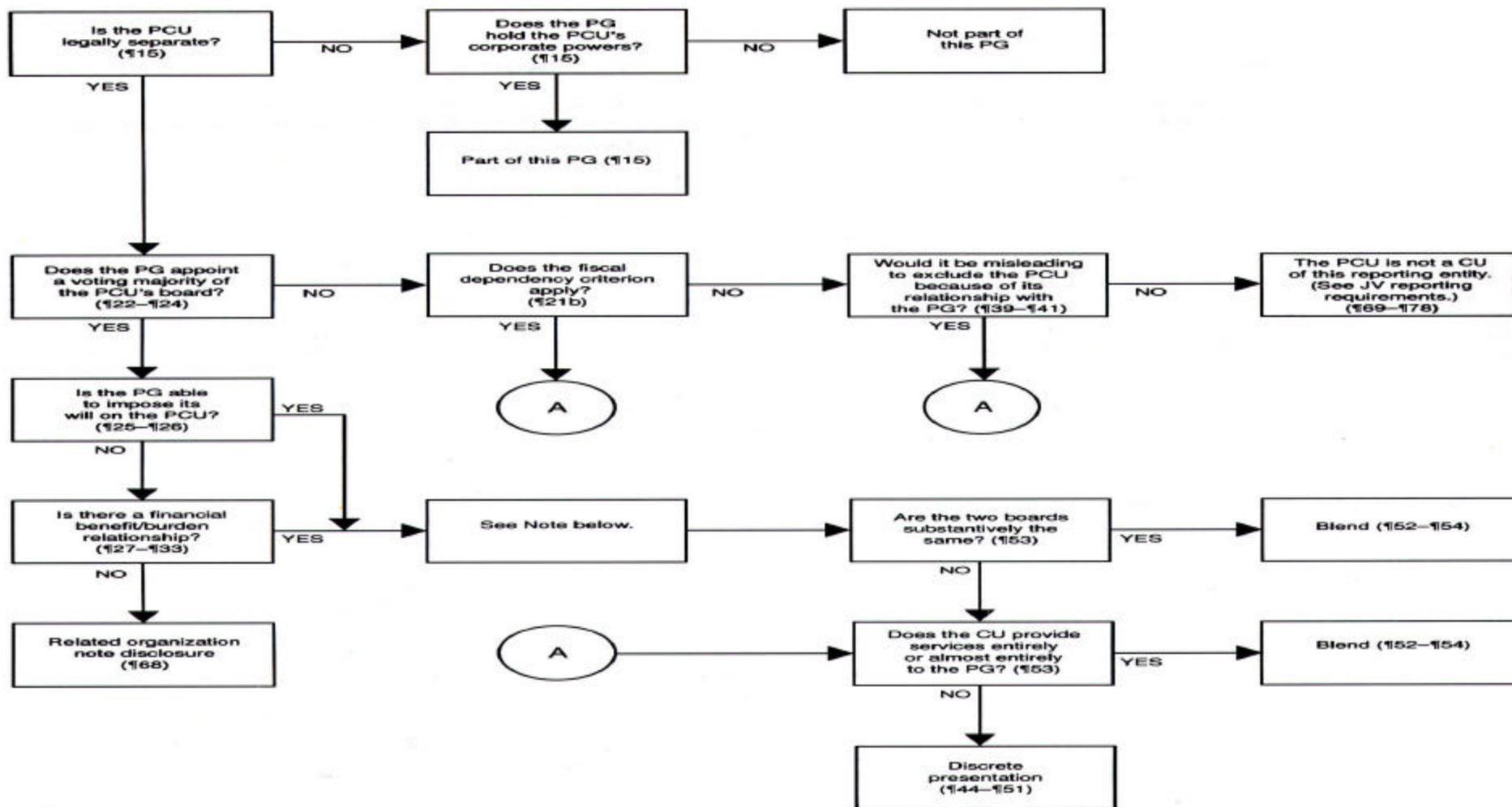
Question: Do the IHBG regulations allow bad debts to be written off as a loss?

Answer: No. Under the programs administered by the ONAP, e.g. IHBG, ICDBG, IHDEP, etc., recipients may not write an off an uncollectable expense and charge it to a program expense. The Indian Housing Programs governed by the '37 Housing Act allowed for uncollectible accounts to be written off when a delinquent tenant moved out. That provision was not carried forward to the IHBG Program.

Question: The GAAP requires that management write-off receivable balances when the account is deemed uncollectible. How can a recipient meet the conflicting requirements of OMB Circular A-87 and GAAP?

Answer: There is no direct conflict between the Circular and GAAP. The Circular indicates that the bad debt expense may not be charged to the Federal grant program. The Circular does not say that the recipient cannot write-off uncollectible accounts receivable. The Federal grant recipient must use non-federal funds to fund the bad debt expense.

Another approach is to create an allowance for doubtful accounts that would offset the accounts receivable for those accounts management believes will not be collected. When the financial statements are prepared, the accounts receivable balance would be net of the allowance for doubtful accounts. This presents an accounts receivable balance that management has a reasonable expectation of collecting. The expense side of the allowance for doubtful accounts is the bad debt expense. As previously stated, Federal funds may not be used to reimburse the account.



Note: A potential component unit for which a primary government is financially accountable may be fiscally dependent on another government. An organization should be included as a component unit of only one reporting entity. Professional judgment should be used to determine the most appropriate reporting entity (§121b and §134-§138). A primary government that appoints a voting majority of the governing board of a component unit of another government should make the disclosures required by §168 for related organizations.

PCU – Potential Component Unit

PG – Primary Government

CU – Component Unit