
CHAPTER 4. MONITORING

SECTION 1. Introduction

4-1. DEFINITION

Monitoring consists of the actions taken by the Asset/Loan Management staff to review the management of a multifamily housing project. The Asset Management staff must monitor the financial activities of the owner and management agent and review audit reports to determine if IPAs are meeting their responsibilities.

4-2. PURPOSE

Monitoring provides continuous knowledge of all aspects of a project's operation, including maintenance and financial status, so that unfavorable conditions may be promptly identified and corrected. The protection of the contingent liability of the Department is important. Good servicing should be promoted by friendly and cooperative assistance to the project owner, but a business relationship between HUD and the owner must be maintained to ensure that both parties perform all required duties.

SECTION 2. Reporting Requirements

4-3. SUBMISSION OF FINANCIAL STATEMENTS AND REPORTS

The owner has primary responsibility for maintaining accounting records and for providing HUD with financial statements and supplemental data at least annually. The owner and the management agent (if applicable) must certify that the statements have been reviewed.

- A. Acceptable Formats. The financial statements should be prepared in accordance with Generally Accepted Accounting Principals (GAAP). See Chapter 2 for more details.
- B. Timeframes for Submission. Most Regulatory Agreements require submission of completed annual financial reports within 60 days after the end of each fiscal year.

- C. References. Asset/Loan Management staff performing these monitoring functions should be familiar with the handbooks included in the foreword of this handbook.

4-4. QUALITY OF FINANCIAL STATEMENTS

- A. Owner's Responsibility to Prepare Complete and Accurate Statements. As previously stated, financial statements should be prepared in accordance with GAAP. The statements should also present accurately the financial position of the entity as of the statement date and the results of its operations and cash flows for the period ended. In addition, the supplemental data, in all material respects, should be fairly presented in relation to the financial statements taken as a whole.
- B. Requirements Auditor Must Follow When Preparing Audit Report. Refer to Chapter 2 of this handbook for details of the components of required audit reports. The prescribed audit report format is contained in HUD Handbook 4370.2.
- C. Management Agent's Responsibility to Maintain Books and Records in Auditable Form. The management agent has the same responsibility as the owner for preparing accurate financial statements and supplemental data. However, it is ultimately the responsibility of the owner to ensure that adequate books of records are maintained and financial statements and supplemental data accurately reflect the results of operations.

SECTION 3. Monitoring Project Owners

4-5. CONCERNS REPORTED BY IPA's

The financial statements submitted by an owner must be reviewed by an Independent Public Accountant (IPA). The IPA will either express an opinion on the accuracy of the financial statements or issue a disclaimer. Normally the IPA will express an opinion on the accuracy of the statements and write notes to the financial statements advising the reader of such items as accounting policy. The auditor is also required to perform a review of compliance with applicable laws and regulations and the internal control structure. If the auditor issues a disclaimer, the Asset/Loan Management staff must work with the project owner/management agent to correct the deficiencies noted by the IPA.

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- A. Reviewing Components of Audit Reports. Chapter 2, Section 3 of this Handbook sets forth the components that should be included in the auditor's reports and notes to financial statements. The following items should be reviewed in order to identify problem areas and weaknesses:
 - 1. Scope of audit
 - 2. Opinion on financial statements and supplemental data
 - 3. Notes to financial statements

4. Evaluation of Compliance With Laws and Regulations
5. Evaluation of Internal Control Structure.

B. Understanding and Interpreting an Audit Report. The Asset/Loan Management staff should be familiar with the General Accounting Office (GAO) Government Auditing Standards (GAS) and the American Institute of Certified Public Accountants (AICPA) Generally Accepted Auditing Standards (GAAS).

1. Government Auditing Standards of Reporting for Government Financial Audits. These standards incorporate the AICPA standards of reporting for financial audits and prescribe supplemental standards of reporting needed to satisfy the unique needs of government financial audits.

- a. The auditor's report should state that the audit was made in accordance with GAAS and GAS. If the report does not contain the above information the auditor must explain the deviations from the above standards.

- b. The auditor should prepare a written report on the tests of compliance with applicable laws and regulations. This report, which may be included in the report on the financial statements 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 also include all material instances of noncompliance, and all instances or indications of improper acts which could result in criminal prosecution.

- c. The auditor should prepare a written report on the understanding of the owner's internal control structure and the assessment of control risk made as part of a financial statement audit, or a financial related audit. This report may be included in either the auditor's report on the financial statements or a separate report. The auditor's report should include as a minimum:

- (1) The scope of the auditor's work in obtaining an understanding of the internal control structure and in assessing the control risk.

- (2) The owner's significant internal controls or control structure including the controls established to ensure compliance with laws and regulations that have a material impact on the financial statements and results of the financial related audit.
 - (3) The reportable conditions, including identification of material weaknesses, identified as a result of the auditor's work in understanding and assessing the control risk.
- d. Written audit reports are to be prepared giving the results of each financial related audit.
 - e. If certain information is prohibited from general disclosure, the report should state the nature of the information omitted and the basis for omitting it.
2. Generally Accepted Auditing Standards (GAAS) for Financial Audits. The four standards of reporting as outlined in GAAS are briefly explained below:
- a. The report shall state whether the financial statements are presented in accordance with Generally Accepted Accounting Principles (GAAP). GAAP are defined as technical accounting terms encompassing accounting rules and procedures that are generally accepted at a particular time. There is no comprehensive list of GAAP, since acceptable

accounting practice is composed of promulgated as well as unwritten accounting principles.

- b. The report shall identify those circumstances in which GAAP has not been consistently applied in the current period in relation to the preceding period. Consistency enhances the comparability of financial statements from year to year. When accounting principles are not consistently applied, the auditor must determine how the change is to be reported and what disclosures must be made.
- c. Informative disclosures to the financial

statements are to be considered immaterial unless otherwise stated. What constitutes "material" for a particular event or for the financial statements as a whole is a matter of the auditor's professional judgement.

- d. The report shall contain either an expression of opinion regarding the financial statements taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons should be stated. When an unqualified ("clean") opinion cannot be issued, the auditor's report must explain the substantive reasons for the deviation from the standard auditor's report. The audit report must carefully describe the nature of the examination and the degree of responsibility taken by the auditor with respect to the financial statements.

An auditor may express an unqualified opinion on all financial statements presented, or the auditor's opinion may be split. For example, the auditor may express an unqualified opinion on the Balance Sheet and a qualified opinion on the Statement of Income and Statement of Cash Flows.

4-6. INFORMATION OBTAINED FROM OTHER SOURCES

Prior year audit reports, HUD Management Reviews, HUD/Mortgagee physical inspection reports, GAO audit reports, and HUD-010 audit reports are properly a part of the project owner's records. The

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engagement letter between the IPA and the project owner should state that the project owner will make the above reports available to the IPA. Asset/Loan Management staff will also have access to the reports listed above and should use this information to determine an owner's compliance with the Regulatory Agreement or other regulations.

- A. Inspector General Audit Reports. The OIG will usually perform a limited number of audits involving multifamily projects. Normally, OIG audits involve evaluating overall program objectives and compliance with regulations and HUD policy. For the most part, the OIG will rely on the audits performed by IPAs in evaluating the financial condition of a project. The OIG, however, reviews and evaluates the adequacy of IPA audit reports.
- B. General Accounting Office Audit Reports. Audits by the GAO

usually involve areas which are of special interest to Congress. As such, they could involve financial or program areas.

- C. Management Review Reports. Financial statement reviews, which are a part of the overall management review process, are performed on an annual basis. This review measures the current and near-term financial stability of the project. If the project is currently experiencing financial difficulties, or if such problems are anticipated to occur within the coming year, Asset/Loan Management staff should attempt to prevent these problems from resulting in an insurance claim. All recommendations should be documented on the Management Review Report. See Handbook 4350.1, "Insured Project Servicing Handbook", for additional information.
- D. Physical Inspection Reports. Physical inspections are required to be performed by HUD Field Office personnel (or third party contractors, when applicable) on many multifamily projects within HUD's portfolio. The timing and frequency of the inspections will depend on the schedule of inspections prepared by the Field Office giving troubled and potentially troubled projects first priority. Inspections are also performed by mortgagees once every calendar year. Each inspection must be documented in writing using Form HUD-9822, "Physical Inspection Report". These inspection reports may reveal unsatisfactory conditions of the project and an estimate of the costs of any necessary repairs. This could have an impact on the overall financial condition of

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the project and, therefore, must be considered in the management and financial review processes.

4-7. COMMUNICATION WITH PROJECT OWNERS

- A. Relationship Between HUD and Project Owners. The relationship between HUD and project owners is of paramount importance in order to maintain good cooperation. The project owner should be kept informed of many actions taken or planned by HUD and should receive timely responses to requests for information or assistance. This is particularly important when the enforcement of sanctions is imminent.
- B. Guidelines for Good Communication.
 - 1. Answer all written request for assistance or information in writing, particularly requests for financial assistance.

2. Consider all reasons, documents and data given by the owner in support of a request for financial assistance or other relief. Consider the effect on project operations if the request is denied. When denying a request for assistance or relief, particularly a request for financial assistance, do the following:
 - a. State all of the reasons why the request has been denied.
 - b. Demonstrate that HUD has considered all of the reasons for the request.
 - c. Maintain a record of all documents that were used to arrive at the decision to deny the request.
3. Answer all written requests for assistance or information within a reasonable period of time.
4. Return all telephone calls from the owner.
5. When an owner requests by telephone any kind of forbearance or relief from a substantive HUD requirement, confirm to the owner that the request for such forbearance or relief must be made in writing.

SECTION 4. Monitoring Independent Public Accountants

4-8. COMPLIANCE WITH REPORTING REQUIREMENTS

- A. Responsibility of IPA's. IPA's responsible for conducting audits of multifamily housing projects are guided by GAAS, GAS, and IG Handbook 2000.4, "Consolidated Audit Guide for Audits of HUD Programs". The audit is performed to determine whether the financial statements present fairly the financial position of the project and the results of its operations and must be comprehensive enough to permit the expression of an opinion on the financial statements and supplemental data in the report.

The audit opinion should state whether the basic financial statements present fairly the financial position of the project as of the audit date and the results of its operations and cash flows for the period then ended in conformity with generally accepted accounting principles. In addition, the opinion should state that the supplemental data has been subjected to the audit procedures applied in the examination of the basic financial statements and is fairly stated in all material respects in relationship to the financial statements taken as a whole.

The IPA is also required to review, evaluate and comment on the adequacy of the accounting records and procedures and the system of internal controls maintained, including the handling of funds. The auditor shall report on the study and evaluation of internal accounting controls made as part of the financial and compliance audit. The auditor must identify at a minimum:

1. The owner's significant internal accounting controls.
2. The controls that were evaluated.
3. The controls that were not evaluated (the auditor may satisfy this requirement by identifying any significant classes of transactions and related assets not included in the study and evaluation).
4. The material weaknesses resulting from the owner's failure to adhere to certain specific provisions of the Regulatory Agreement or Corporation Charter and to specific HUD regulations.

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The IPA is also required to review the project owner's compliance with applicable laws and regulations and issue an opinion as to the degree of compliance.

Finally, the IPA and the auditee (i.e., project owners) are required to submit the following reports as appropriate:

- o Management Letter or Schedule of Findings and Questioned Costs
 - o Auditor's Comments on Audit Resolution Matters
 - o Auditee's Response or Corrective Action Plan
- B. Audit Requirements. In order that the project owners and HUD may be assured of the project's effectiveness in meeting its program objectives, IG Handbook 2000.4, "Consolidated Audit Guide for Audits of HUD Programs", provides guidance for the IPA in the audit of compliance and internal control matters which are of particular interest to HUD.
- C. Responsibility of Project Owners. As detailed in Section 2 of this chapter, project owners and management agents have the ultimate responsibility for the preparation and certification of all financial statements. They must ensure that all necessary statements and supplemental data are available to the auditor.

4-9. CONCERNS COMMUNICATED BY PROJECT OWNERS

Asset/Loan Management staff can obtain information on the quality of an IPA's performance by communication with the project owner during the performance of the audit and after the exit conference. The owner may also communicate if the audit was performed in accordance with the requirements of the engagement letter. The project owner should notify the Asset Management staff in writing if the audit report is considered to be incorrect.

4-10. REVIEW OF IPA'S WORKING PAPERS

- A. Authorization to Review Working Papers. The audit engagement letter or other arrangements for audit between the IPA and project owner must allow for duly authorized agents of the Secretary to examine the IPA's working papers supporting the audit report.

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- B. General Conditions and Completeness. Reports of audits performed by IPA's must be in accordance with IG Handbook 2000.4. Whenever an evaluation of an audit report or working paper discloses inadequacies, Asset/Loan Management staff may choose to refer the report to the OIG for further action. The audit report should include the name, firm address, and telephone number of the senior auditor on the engagement and the IPA's Federal Employer ID Number.

SECTION 5. Maintaining Documentation

4-11. IMPORTANCE OF DOCUMENTATION

Records are basic documents the government uses to perform its duties. As every action, decision, and policy is documented, records are created. Records serve many purposes and contain evidence of financial and legal commitments. Documents must be retained by the Asset/Loan Management staff for future use by:

- o auditors,
- o management officials, and
- o OIG.

4-12. DOCUMENTS

The following documents should be retained by Asset Management staff.

- A. Copies of Management Review Reports and related documents.
- B. Copies of Financial Statements and related documents.

- C. Copies of Physical Inspection Reports.
- D. Copies of Audit Reports.
- E. Copies of contracts.
- F. Memos to the file regarding important telephone calls.
- G. Copies of correspondence to and from project owners and managing agents.