



**U.S. Department of Housing and Urban
Development
Office of Housing Counseling**

How To Read Financial Statements

Wednesday, March 18, 2015

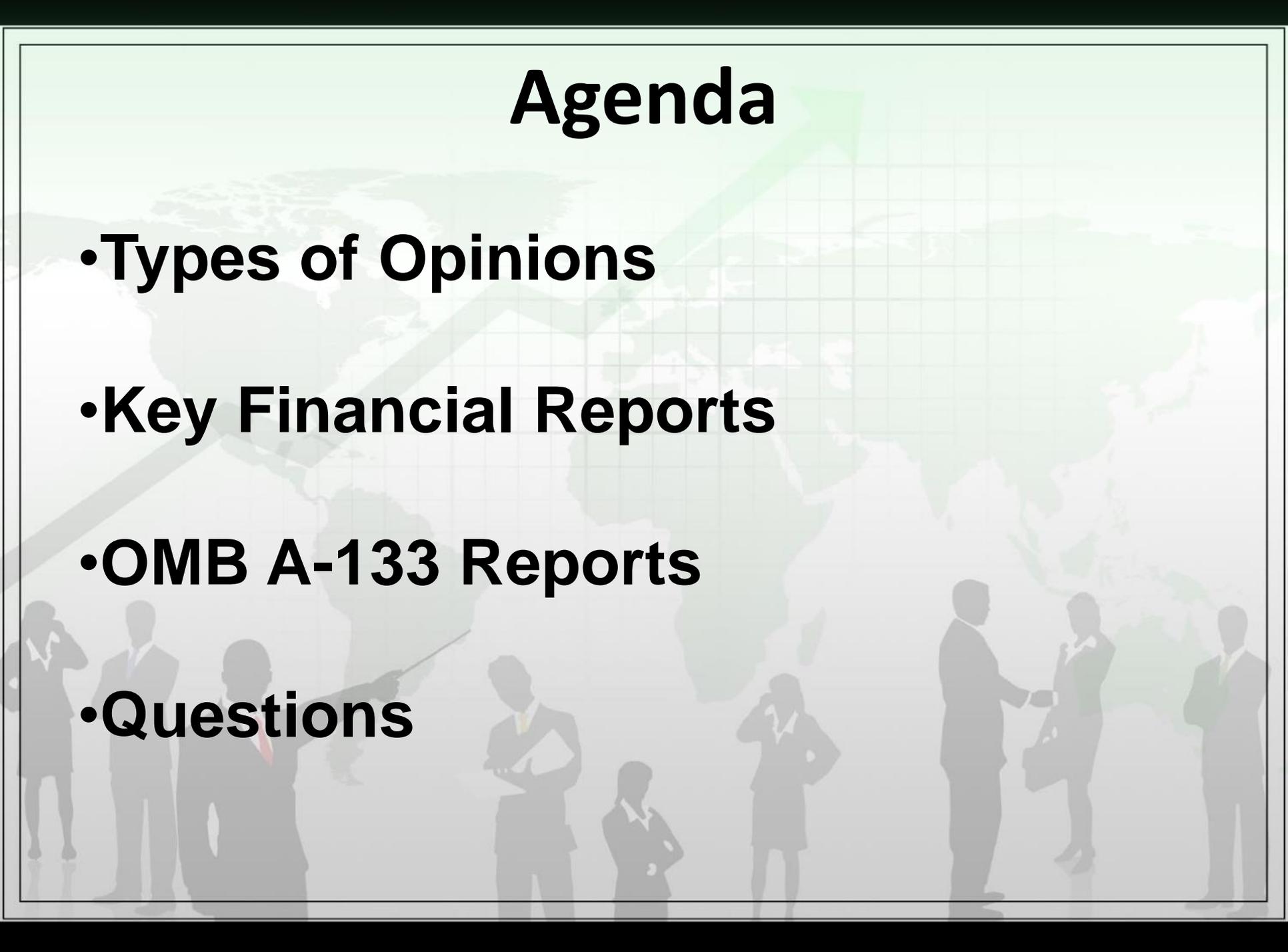
12:00 PM Eastern Standard Time

Facilitated by

Booth Management Consulting, LLC

7230 Lee Deforest Drive, Suite 202, Columbia, MD 21046

Agenda



- **Types of Opinions**
- **Key Financial Reports**
- **OMB A-133 Reports**
- **Questions**

Today's Objectives

- To provide analytical discussion on the fundamentals of reviewing audit reports
- Discuss “red” flag notations or findings
- Indicators of financial performance

Audit Opinions

- Unmodified (Unqualified)
- Modified (Qualified)
- Going Concern
- Disclaimer
- Adverse



Audit Opinions

- **Unmodified (Unqualified)**
 - An independent auditor's judgment that a company's financial records and statements are fairly and appropriately presented, and in accordance with Generally Accepted Accounting Principles (GAAP). An unqualified opinion is the most common type of auditor's report.

APPENDIX 13A-1

Standard Report—Voluntary Health and Welfare Organization

INDEPENDENT AUDITOR'S REPORT^a

To the Board of Trustees of
ABC Organization^b

We have audited the accompanying statement of financial position of ABC Organization (a nonprofit organization)^c as of June 30, 20X1, and the related statements of activities, functional expenses, and cash flows for the year then ended.^d These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audit.^e

We conducted our audit in accordance with auditing standards generally accepted in the United States of America.^f Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.^g

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ABC Organization as of June 30, 20X1, and the changes in its net assets^h and its cash flowsⁱ for the year then ended in conformity with accounting principles generally accepted in the United States of America.^j

Firm's signature

City, State
August 15, 20X1

Notes:

- ^a SAS No. 58 (AU 508) requires the auditor's report to have a title that includes the word "independent."
- ^b The report is addressed to the governing board (for example, the board of directors or trustees). The report could be addressed to the organization itself if the client so desires.
- ^c If the nature of the organization is not evident from its name, the fact that it is a nonprofit organization may, but need not, be disclosed parenthetically.
- ^d The report uses the financial statement titles referred to in FASB ASC 958-205-55-2 (formerly SFAS No. 117), although those titles are not mandated. The statements covered by the report should be identified using the titles that appear on the financial statements. Thus, for example, if the organization titles the statement of financial position "balance sheet," that title would be used; or, if a separate statement of unrestricted revenues, expenses, and other changes in unrestricted net assets is presented, it would be identified in the introductory paragraph.
- ^e The standard report prescribed by SAS No. 58 (AU 508) includes two sentences in the opening (introductory) paragraph indicating the respective responsibilities of management and the auditor.

Audit Opinions

- **Modified (Qualified)**
 - Modified or qualified audit opinions are given for two reasons. The first is scope limitation, which means that the auditor doesn't have access to enough information, or to relevant information. The second is in the circumstance that there is a departure from applicable financial reporting framework, which may be the result of either an accident or negligence on the part of the client being audited.

Audit Opinions

- **Going Concern**
 - The most well-known adverse opinion is the "going-concern" exception, in which the accountant expresses doubts about the company's ability to remain in business.



APPENDIX 13B-9

Report Modification Because of an Uncertainty—Going Concern Uncertainty—Voluntary Health and Welfare Organization

INDEPENDENT AUDITOR'S REPORT

To the Board of Trustees of
ABC Organization

We have audited the accompanying statement of financial position of ABC Organization (a nonprofit organization) as of June 30, 20X1, and the related statements of activities, functional expenses,^a and cash flows^b for the year then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ABC Organization as of June 30, 20X1, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.^c

The accompanying financial statements have been prepared assuming that the Organization will continue as a going concern. As discussed in note X to the financial statements, the Organization has suffered recurring significant reductions in grant revenues and has a net deficiency in net assets that raise substantial doubt about its ability to continue as a going concern. Management's plans regarding these matters also are described in note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.^d

Firm's signature

City, State
August 15, 20X1

Notes:

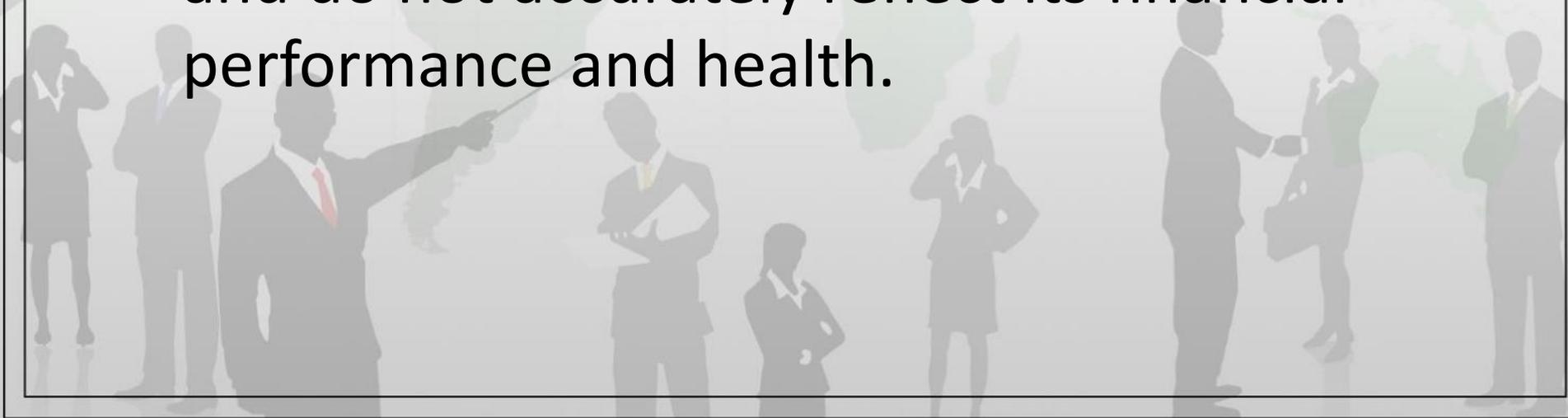
- a The report can be adapted for an organization other than a voluntary health and welfare organization by deleting the reference to functional expenses in the first paragraph.
- b The report uses the financial statement titles referred to in FASB ASC 958-205-55-2 (formerly SFAS No. 117), although those titles are not mandated. The statements covered by the report should be identified using the titles that appear on the financial statements. Thus, for example, if the organization titles the statement of financial position "balance sheet," that title would be used; or, if a separate statement of unrestricted revenues, expenses, and other changes in unrestricted net assets is presented, it would be identified in the introductory paragraph.
- c The first three paragraphs are identical to a standard unmodified report, and the opinion is unmodified.
- d A separate paragraph following the opinion paragraph refers to the note to the financial statements that describes the uncertainty. SAS No. 64 (AU 341.12) explicitly requires use of the phrase "substantial doubt about the entity's ability to continue as a going concern" or similar wording that includes the terms *substantial doubt* and *going concern*. If the auditor believes that the financial statements do not adequately disclose the uncertainty, the auditor should express a qualified opinion because of a GAAP departure. In addition, SAS No. 77 (AU 341.13) precludes auditors from using conditional language to express a conclusion about an entity's ability to continue as a going concern, since it may leave users unsure about the auditor's conclusions. Key phrases that auditors should avoid in explanatory going concern paragraphs are "if" and "may be." However, other phrases with similar meaning could also be considered conditional and should be avoided.

Audit Opinions

- **Disclaimer**
 - An auditor may decide to issue a disclaimer of opinion if one of four circumstances are applicable: a lack of independence, scope limitations, substantial doubt about the organization's ability to survive or matters involving uncertainties.

Audit Opinions

- Adverse
 - A professional opinion made by an auditor indicating that a company's financial statements are misrepresented, misstated, and do not accurately reflect its financial performance and health.



Audit Opinions

- Audit Report Date
 - OMB Circular A-133 requires the audit to be completed nine months after the end of the audit period.
 - Auditors are required to submit it to the Federal Clearinghouse within the nine month timeframe.



Key Financial Statements

- Statement of Financial Position
- Statement of Activities
- Cash Flow
- Functional Expenses



Key Financial Statements

- Statement of Financial Position
 - Total Assets, Liabilities, Net Assets
 - Composition of Net Assets
 - Unrestricted
 - Temporarily Restricted
 - Permanently Restricted
 - Ratio of Current Assets to Current Liabilities
 - Significant Current Portion of Long-term Debt

Key Financial Statements

- Statement of Activities
 - Net loss is not always a bad thing
 - Non-cash transactions
 - Large fluctuations
 - Leveraging of funds from non-governmental sources

Key Financial Statements

- Cash Flow
 - Operating
 - Investing
 - Financing
- Functional Expenses
 - Ratio of Program, Administrative, and Fundraising to Total
 - United Way Benchmark – 75% Program

Key Areas of Basic Footnotes

- Debt
- Commitments/Contingencies
- Separate Legal Footnotes
- Subsequent Events

OMB A-133 Reports

- Types of Reports
- Where to look for Findings
- How to Understand Findings



OMB A-133 Reports

- Types of Reports

- Report on **Internal Control** Over Financial Reporting and on Compliance and Other Matters Based on and Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*
- Report on **Compliance** with Requirements That Could Have a Direct and Material Effect on each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133

APPENDIX 13G-3

Government Auditing Standards Report on Internal Control over Financial Reporting and on Compliance and Other Matters—with Material Weaknesses and Significant Deficiencies and Reportable Instances of Noncompliance, and Other Matters Identified

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS^{a, b, c}

To the Board of Trustees of
ABC Organization

We have audited the financial statements of ABC Organization (a nonprofit organization) as of and for the year ended June 30, 20X1, and have issued our report thereon dated August 15, 20X1. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting^{d, e}

In planning and performing our audit, we considered ABC Organization's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of ABC Organization's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and questioned costs,^f we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and questioned costs^f to be material weaknesses. [List the finding reference numbers, for example, 20X2-3 and 20X2-4.]

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompany schedule of findings and questioned costs^f to be significant deficiencies. [List the finding reference numbers, for example, 20X2-2 and 20X2-5.]

Compliance and Other Matters^g

As part of obtaining reasonable assurance about whether ABC Organization's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing*

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Standards and which are described in the accompanying schedule of findings and questioned costs^f as items [List the finding reference numbers, for example, 20X2-5 and 20X2-6.]

We noted certain matters that we reported to management of ABC Organization in a separate letter dated August 15, 20X1.

ABC Organization's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit ABC Organization's response and, accordingly, we express no opinion on it.^{f, g, h}

This report is intended solely for the information and use of management, [Identify the body or individuals charged with governance.], others within the entity, the Board of Trustees, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Firm's Signature

City, State

August 15, 20X1

APPENDIX 11C-1

Single Audit Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control over Compliance—with Unqualified Opinion on Compliance; No Material Weaknesses or Significant Deficiencies

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133^{a, b}

[Addressee]^c

Compliance^d

We have audited [Name of Governmental Entity or Nonprofit Organization]'s compliance with the types of compliance requirements^e described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of [Name of Governmental Entity or Nonprofit Organization]'s major federal programs for the year ended [Date]. [Name of Governmental Entity or Nonprofit Organization]'s major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.^f Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of [Name of Governmental Entity or Nonprofit Organization]'s management. Our responsibility is to express an opinion on [Name of Governmental Entity or Nonprofit Organization]'s compliance based on our audit.^g

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States;^h and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.ⁱ Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about [Name of Governmental Entity or Nonprofit Organization]'s compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of [Name of Governmental Entity or Nonprofit Organization]'s compliance with those requirements.^j

In our opinion, [Name of Governmental Entity or Nonprofit Organization] complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended [Date].^k However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items [List finding reference numbers, for example, 20X1-1 and 20X1-2].^l

Internal Control Over Compliance^d

Management of [Name of Governmental Entity or Nonprofit Organization] is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered [Name of Governmental Entity or Nonprofit Organization]'s internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of [Name of Governmental Entity or Nonprofit Organization]'s internal control over compliance.^m

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent,

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or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.ⁿ

[Name of Governmental Entity or Nonprofit Organization]'s responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit [Name of Governmental Entity or Nonprofit Organization]'s responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of management, [Specify the body or individuals charged with governance.], others within the entity, [Specify legislative or regulatory body.], federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.^o

[Firm's Signature]

[City, State]

[Date] ^p

Where to Look for Findings

- OMB A-133 reports
 - Schedule of Findings and Questioned Costs



Example 1

City of Dogwood, North Carolina
Schedule of Findings and Questioned Costs
For the Fiscal Year Ended June 30, 201X

Section I. Summary of Auditor's Results

Financial Statements

Type of auditor's report issued: **Unmodified**

Internal control over financial reporting:

- Material weakness(es) identified? X yes ___no
- Significant Deficiency(s) identified that are not considered to be material weaknesses? ___yes X none reported

Noncompliance material to financial statements noted ___yes X no

Federal Awards

Internal control over major federal programs:

- Material weakness(es) identified? ___yes X no
- Significant Deficiency(s) identified that are not considered to be material weaknesses? ___yes X none reported

Type of auditor's report issued on compliance for major federal programs: **Unmodified**

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of Circular A-133 ___yes X no

Identification of major federal programs:

<u>CFDA No.</u>	<u>Names of Federal Program or Cluster</u>
66.458	Capitalization Grants for Drinking Water State Revolving Fund
97.036	Disaster Grants - Public Assistance (Presidentially Declared Disasters)

City of Dogwood, North Carolina
Schedule of Findings and Questioned Costs
For the Fiscal Year Ended June 30, 201X

Dollar threshold used to distinguish
between Type A and Type B Programs
Auditee qualified as low-risk auditee?

\$__300,000
____yes X no

State Awards

The only major State program for the City of Dogwood is the **Capitalization Grants for Drinking Water State Revolving Fund (66.458), which is a State match on a federal program. Therefore, this program has been included in the list of major federal programs above.**

Section II – Financial Statement Findings

MATERIAL WEAKNESS

0X – 1 Segregation of Duties

Criteria: Duties should be segregated to provide reasonable assurance that transactions are handled appropriately.

Condition: There is a lack of segregation of duties among City personnel.

Effect: Transactions could be mishandled.

Cause: There are a limited number of personnel for certain functions.

Recommendation: The duties should be separated as much as possible, and alternative controls should be used to compensate for lack of separation. The governing board should provide some of these controls.

Views of responsible officials and planned corrective actions: The city agrees with this finding and will adhere to the correction action plan on page 35-E-6.4 in this audit report.

City of Dogwood, North Carolina
Schedule of Findings and Questioned Costs
For the Fiscal Year Ended June 30, 201X

Section III – Federal Award Findings and Questioned Costs

None reported.

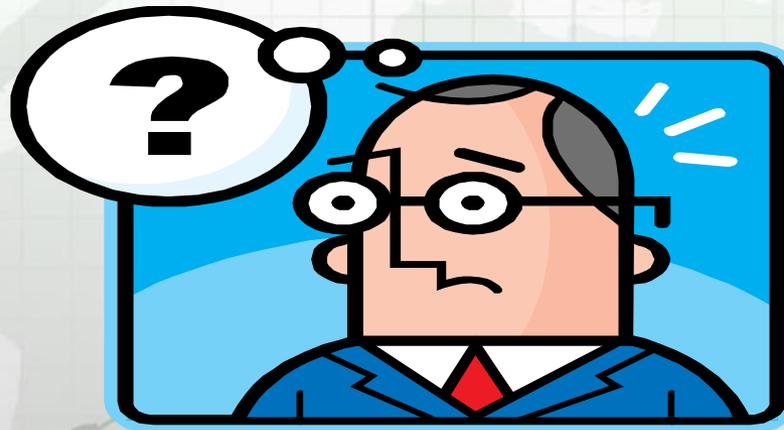
Section IV – State Award Findings and Questioned Costs

None reported.

How to Understand Findings

- Common Findings
 - Lack of Segregation of Duties
 - Lack of Ability to Prepare a Complete Set of Financial Statements including Footnotes
- Other Findings
 - Questioned Costs, Reporting, etc.
 - Are they repeat findings?

Questions?



THANK
YOU

