## F. Audited Annual Financial Statements

The owner is required to submit to PHFA audited annual financial statements of the development for each fiscal year, or portion thereof, after initial occupancy. The financial statements and supporting schedules of the report should be prepared consistent with the formats contained in this section, and should be presented in accordance with accounting principles generally accepted in the United States of America. An electronic PDF copy of the report must be submitted to the Housing Management Division of PHFA within ninety days following the end of each property's fiscal year. In addition, a PHFA Statement of Profit and Loss and a Balance Sheet must be entered via the PHFA website. See Section G. for instructions on website submission.

The requirements listed in this section apply to all properties financed by the Agency, **including TCAP, Exchange, HRA and PHARE properties**, with the following exceptions:

a. HUD-Insured Properties

For those properties that have a HUD-insured mortgage, electronic submission of financial information to REAC is required. The complete financial reporting requirements and instructions to be followed when completing the audit can be found at the following web address:

http://portal.hud.gov/hudportal/HUD/program_offices/public_indian_housing/reac

The Agency also requires that an electronic PDF copy of the audit be submitted to PHFA, along with entry of the Statement of Profit and Loss and Balance Sheet to the Agency's website. These properties are not required to follow the audit guidance reflected in this financial reporting manual. Any questions on whether the property to be audited contains a HUD-insured first mortgage should be directed to the financial analyst assigned to the property.

b. PennHOMES Properties with Eleven (11) Units or Less

Properties funded from the PennHOMES Program which have no amortizing first mortgage and have eleven (11) or less units are not required to submit audited financial statements. Please refer to page 10 for the year-end reporting requirements for these properties. If the Owner is required to have audited financial statements prepared by another funding source, or chooses to have an audit prepared, two (2) copies of the audit should be submitted to the Agency in lieu of any other year-end reporting requirements.

The financial statements and schedules are to be audited by an independent certified public accountant with the purpose of expressing an opinion thereon. The certified public accountant is to be selected by the owner and should be acceptable to PHFA. The certified public accountant must not have a business relationship with the owner or management agent except for the performance of the audit.

The audit is to be performed in accordance with auditing standards generally accepted in the United States of America and the standards applicable for financial audits contained in *Government Auditing Standards*, issued by the Comptroller

General of the United States. There are to be no limitations or restrictions placed by the owner or the management agent on the scope of the audit.

The affairs of the development should be conducted in such a manner as to allow for the issuance of an unqualified opinion. The opinion should state whether the basic financial statements present fairly the financial position of the development as of the audit date and the results of its operations and changes in partners' capital and cash flows for the period then ended in conformity with accounting principles generally accepted in the United States of America applied on a basis consistent with that of the preceding period. In addition, the opinion should state that the supplemental data has been subjected to the audit procedures applied in the audit of the basic financial statements and is fairly presented in all material respects in relationship to the financial statements taken as a whole.

A first year audit is required for all PHFA funded properties (**including TCAP, Exchange, HRA and PHARE**) that consist of 12 or more units. This audit is required as of the end of the fiscal year during which operations commence. An audit is always required unless a waiver has been granted by PHFA. A written request to waive the first year's audit may be considered when the property is only open for a short time and generates little or no income. In this instance, a request to waive the first year audit may be submitted to the Manager of Financial Operations, along with the reason for the waiver. No waiver will be granted if the property generates operating income for more than one month.

The audit is required to identify the property's **operating** cash flow and working capital. The Agency is primarily interested in funds necessary to maintain the ongoing operations of the property. Recognizing that the audit is generally a partnership audit, any non-operating partnership activity should be separately disclosed in the Balance Sheet, Statement of Profit and Loss, and Statement of Cash Flows. Examples of non-operating items that should be separately disclosed on the Balance Sheet are the following:

- General Partner accounts
- Accounts receivable – syndication proceeds
- Accounts receivable – operating subsidy
- Construction funds escrow
- Accounts payable – construction
- Accounts payable – developer's fee
- Accounts payable – General Partner or Limited Partner
- Advance – GP developer fee
- Advances to operating from owner
- Notes payable – GP

Any liability noted above should disclose the repayment source in the Notes to the Financial Statements.

Examples of items that should not be paid from operating funds and should not appear on the PHFA Profit and Loss Statement, other than under the category Corporate or Mortgagor Entity Expenses, are the following:

- Cost certification audit
- Bookkeeping charges or accounting fees, with the exception of the Agency authorized fees for properties constructed under the Section 8 Program
- Data processing fees
- Budgeted rent-up expenses reimbursed by PHFA
- Construction interest payable with construction funds
- Any other expenses reimbursed from a payout by PHFA
- Partnership checking account charges
- Interest income on the partnership bank accounts
- Partnership administrative/investor fee (This expense is permitted to be charged if budgeted on the property's Financial Spreadsheet. Contact the Financial Analyst currently in charge of the property if you are uncertain if this is allowable).
- Opening ceremony/dedication charges
- Expenses for the consultant who helped underwrite the property
- Payments to the mentor of the management agent
- Limited Partnership syndication fees
- Tax credit monitoring fees and consulting charges
- Partnership legal fees
- Interest Income Supportive Service Escrow
- Partner State Taxes
- Interest Income Operating Deficit Fund
- Interest Income Operating Deficit Reserve
- Interest Income Operating Reserve
- Interest Income Development Contingency Fund
- All charges associated with refinancing or re-syndicating the property including but not limited to:
    - Appraisals
    - Consulting fees
    - Financing fees
    - Property surveys
    - Engineering studies
    - Loan processing fees
    - Environmental studies
    - Rent comparability studies
    - Physical needs assessments
    - Depreciation analysis and studies

**The above list is not meant to be all inclusive.**

If any of the above items were paid from the property's operating account in error, a receivable should be booked at year-end indicating repayment will take place the following fiscal year from partnership funds.

All financial statements submitted to PHFA must contain the following, if applicable:

a. Comparative Balance Sheets - The balance sheet must contain comparative information for both the current year and the preceding year. The property's operating and non-operating accounts must be separately disclosed on the balance sheets.

b. Comparative Statements of Profit and Loss - This will include information for the current year and the preceding year. All non-operating income or expense items must appear under Corporate or Mortgagor Entity Expenses. An explanation of the accounts can be found in PHFA's Chart of Accounts section of this manual. The form is available on the Internet at www.PHFA.org. under Multifamily Housing Professionals, then click on Property Managers or CPA's.

c. Comparative Statement of Changes in Owner's Equity - This will include the beginning balance, additions, and deductions during the current operating year and the preceding year.

d. Comparative Statement of Cash Flows - The statement must reflect how funds were provided and applied for all cash and certain non-cash outlays to reflect the net increase or decrease in cash during the current year and the preceding year. **The statement must reflect cash activity from the property's operating sources separately from non-operating sources**. PHFA requires that the **direct method** be used when preparing this schedule.

e. Notes to the Financial Statements - This will include notes relative to the organization of the development and policy changes affecting the preparation of the financial statements and account balances, as well as significant accounting policies that have been followed in the preparation of the financial statements. Detailed disclosure of related party activity and loans and/or notes payable is important to PHFA for their analysis of the property's operations. Related party items must reveal a listing of identity-of-interest companies, owner and/or the management agent, conducting business with the development, along with a breakdown of services rendered and amounts received. Information on the loans or notes payable must include the date incurred, original amount, purpose, terms of repayment, creditor, and balance due. **All** mortgages should also include the maturity date. Where applicable, the appropriate section of the Partnership Agreement must be referenced.

f. Supporting Data – Please see Appendix 1 to this manual for examples of the required formats. This data will be in the form of explanatory comments or schedules as appropriate and includes the following:

1. A detailed analysis of any *accounts or notes receivable* other than regular resident accounts. This analysis should include the date acquired, original amount, terms, name of borrower, and balance due.

2. A summary analysis of *delinquent tenant accounts receivable*, including the number of residents and amounts delinquent for 30 days, 31-60 days, 61-90 days, and over 90 days.

3. An analysis of all *reserve funds* noted on the property's balance sheet This may include such items as an operating deficit reserve, an operating deficit fund, a development contingency fund, etc.. This analysis should record the beginning balance, deposits, withdrawals, interest and ending balance.

4. An analysis of all *escrow funds* maintained on the property that are listed on the balance sheet. This will include the tax escrow, insurance escrow and may include a supportive service escrow, incomplete items escrow and/or any other property related escrow accounts held by the Agency or the property. This analysis should record the beginning balance, deposits, withdrawals, and ending balance.

5. A schedule showing full details and explanations of any *changes in the fixed asset accounts* during the current year. **The schedule must reflect the amount of additions paid from the property's operating account separately from those paid from non-operating sources.** This schedule should be completed even if no changes were recorded. The schedule should also include full details on any fixed asset deletions for the year.

6. An itemized schedule of all operating payables including the vendor name, purpose and the amount. All amounts due to PHFA included in operating payables must be identified separately. This schedule is required for all properties financed by the Agency.

7. The *computation of surplus cash and return on equity* should be completed as per the format and instructions provided. This form is also available on the Agency website.

g. <u>Auditor's Reports</u> – The statement must include a section containing reports on the following:

1. A report on the auditor's evaluation of the internal control over financial reporting of the mortgagor.

2. A report on the compliance with PHFA rules and regulations as well as HUD or other regulatory agencies, where applicable.

A combined report may be prepared that includes both items.

h. <u>Name and Address of the Lead Auditor</u> – The name, address, email address and phone number of the lead auditor should be provided to assist in the review of the audited financial statement.

i. <u>Owner's Signed Representation Letter</u> - Although the financial statements are prepared by the independent certified public accountant, they are the representations of the owner, and it is the owner's responsibility to examine the financial statements prior to their submission to PHFA. Therefore, PHFA requires a signed representation statement by the owner when owned by an individual, by the general partner(s) when owned by a partnership, or by two officers when owned by a corporation.

j. <u>Management Agent's Signed Representation Letter</u> - Since it is the Management Agent's responsibility to maintain the accounting records, PHFA requires the Agent to sign a representation letter prior to submitting the financial statements to PHFA.

The aforementioned statements and supporting data are essential to PHFA's analysis. Any financial statements that do **not** include the required information will be returned for proper completion. Any additional expense incurred for returned financial statements **may not** be paid from the property's operating account, but rather by the owners and/or management agent.

**In addition, a copy of the Management Letter should also be submitted with the financial statements if prepared by the Auditor.**