

Schedule of Federal Audit Findings and Questioned Costs

Joint City of Republic-Ferry County Housing Authority January 1, 2010 through December 31, 2010

1. **The Authority's internal controls were inadequate to ensure compliance with federal regulations, resulting in it missing the federal Single Audit deadline.**

CFDA Number and Title:	10.415 Rural Rental Housing Loans 10.427 Rural Rental Assistance Payments
Federal Grantor Name:	U.S. Department of Agriculture
Federal Award/Contract Number:	NA
Pass-through Entity Name:	NA
Pass-through Award/Contract Number:	NA
Questioned Cost Amount:	\$0

Background

Housing Authority management, the state Legislature, state and federal agencies and bondholders rely on financial statements and reports to make decisions. It is the responsibility of Housing Authority management to design and follow internal controls that provide reasonable assurance regarding the reliability of financial reporting. Our audit identified significant deficiencies in controls to meet federal requirements that could adversely affect the Housing Authority's ability to obtain future federal funding.

Government Auditing Standards, prescribed by the Comptroller General of the United States, require the auditor to communicate material weaknesses as defined below in the Applicable Laws and Regulations section, as a finding.

In 1993 the U.S. Department of Agriculture Rural Development Division granted the Housing Authority a multi-family housing loan in the amount of \$493,000 to provide adequate, affordable, decent, safe and sanitary rental units for low- and moderate-income households in rural areas.

While this loan is in place, the Housing Authority is required to comply with specific federal regulations.

Description of Condition

We identified the following control deficiencies that collectively represent a material weakness in internal controls for meeting federal regulation requirements:

- The Housing Authority did not have procedures to compile its financial statements in a timely manner to ensure the State Auditor's Office could complete the audit by the Federal Clearinghouse deadline.
- The Housing Authority did not have sufficient knowledge of Rural Development's on-line system to use it to report tenant certifications that determine rental assistance, interest subsidies and annual program financial and budget information.
- The Housing Authority did not have a current management plan approved by the grantor.
- The Housing Authority did not know it had to establish separate bank accounts for tenant security deposits.

Cause of Condition

Housing Authority management did not have sufficient understanding of federal regulations to establish controls and meet compliance requirements.

Effect of Condition

Because the Housing Authority did not compile its financial statements in a timely manner, we were unable to complete the audit within the prescribed timeline. Further, the Housing Authority did not request an extension to the audit deadline as required by Circular A-133. Failure to comply with the requirements of its federal grant will result in the Housing Authority being classified as a high risk auditee, increase its audit costs and could result in a loss of future federal funding and/or loss of managing the housing project.

Recommendation

The Housing Authority should establish procedures to ensure the accurate and timely submission of its annual financial reports to ensure it complies with federal reporting requirements. In addition, the Authority should seek adequate training to ensure federal compliance requirements are met.

Housing Authority's Response

The Housing Authority did not have procedures to compile its financial statements in a timely manner to ensure the State Auditor's office could complete the audit by the Federal Clearinghouse deadline.

The Housing Authority was on a biannual schedule for audits. We were not aware until June 2011 that this schedule had changed to an annual basis. At that time we were in the process of an upgrade to our accounting software. In addition to that there was a delay in that we did not receive bids from CPA firms in a timely manner.

The Housing Authority did not have sufficient knowledge of Rural Developments on-line system to use it to report tenant certifications that determine rental assistance.

Corrections to the Rural Development on-line system were completed prior to the SAO audit.

The Housing Authority did not have a current management plan approved by the grantor.

Although we concur that a current approved management plan was not in place for a property, the management plan was in fact submitted to RHS in December 2010 for approval.

The Housing Authority did not know it had to establish separate bank accounts for tenant security deposits.

Tenant security deposits are in a separate account. However, they are comingled with other security deposits but accounted for separately. RHS has reviewed this account numerous times through the years and it has not been a problem. We await further instruction from RHS on this issue.

Auditor's Remarks

We thank the Housing Authority for its cooperation and appreciate the steps it is taking to resolve this issue. We will follow up on this issue during our next audit.

Applicable laws and Regulations

7 CFR 3560 Subpart G—Financial Management, states in part:

Section 3560.301 General.

This subpart contains requirements for the financial management of Agency-financed multi-family housing (MFH) projects, including accounts, budgets, reports, and engagements. Financial management systems and procedures must cover all housing operations and provide adequate documentation to ensure that program objectives are met.

Section 3560.302 Accounting, bookkeeping, budgeting, and financial management systems, states in part:

(a) *General.* Borrowers must establish the accounting, bookkeeping, budgeting and financial management procedures necessary to conduct housing project operations in a financially safe and sound manner. Borrowers must maintain records in a manner suitable for an engagement and must be able to report accurate operational results to the Agency from these accounts and records.

(b) *Acceptable methods of accounting.*

(1) Borrowers may use a cash, accrual, or modified accrual method of accounting, bookkeeping, and budget

preparations as long as the method is consistent with the statements required by the engagement in accordance with the standards identified in § 3560.308.

(2) Borrowers must describe their accounting, bookkeeping, budget preparation, and financial reporting procedures, including Agency-approved engagements, in their management plan.

(3) Borrowers must notify the Agency of any changes in their accounting, bookkeeping, budget preparation, and financial management reporting systems through a revision of their management plan.

(c) *Account requirements.* (1) As used in this paragraph, the term account is used interchangeably to mean a bookkeeping account (ledger) or a bank account.

(2) At a minimum, borrowers must maintain the accounts required by their loan agreement or resolution . . .

(6) Tenant security deposit accounts or membership fee accounts and patron capital accounts must be maintained in a separate account in trust for the tenants or members and handled in a manner consistent with state and local laws.

Section 3560.303 Housing project budgets, states in part:

(a) *General requirements.* (1) Using an Agency-approved format, borrowers must submit to the Agency for approval a proposed annual housing project budget prior to the start of the housing project's fiscal year. The capital budget section of the annual project budget must include anticipated expenditures on the project's long-term capital needs as specified in § 3560.103(c)....

(d)(2) If no rent change is requested, borrowers must submit budget documents for Agency approval 60 calendar days prior to the start of the housing project's fiscal year. The Agency will notify borrowers if the budget submission does not meet the requirements of paragraphs (a), (b), and (c) of this section. The borrower will have 10 days to submit the additional material.

(3) If a rent change is requested, the borrower must submit budget documents to the Agency and notify tenants of the requested rent change at least 90 calendar days prior to the start of the housing project's fiscal year.

Section 3560.307 Reports.

(a) *Required reports.* Borrowers must submit required reports using Agency approved formats.

(b) *Quarterly and monthly reports.* The Agency may require quarterly or monthly reports to monitor financial progress when closer supervision is warranted.

Section 3560.308 Annual financial reports.

(a) *General.* Borrowers must submit annual financial reports that meet the requirements of this section. The annual financial reports to be submitted are the Multi-Family Housing (MFH) Project Budget with actual expenditures and the MFH Balance Sheet. Annual financial reports are due to the Agency within 90 days of the end of the borrower's fiscal year.

(1) Borrowers with 16 or more units in their housing project must base their annual financial reports on an engagement report completed according to agreed upon procedures established by the Agency as specified in paragraph (b) of this section. Borrowers must include the engagement report with their annual financial reports submitted to the Agency.

(2) Borrowers with less than 16 units in their housing project must submit annual financial reports using a limited scope engagement based on Agency approved procedures and certify that the housing meets the performance standards established in paragraph (c) of this section. Borrowers may use a CPA to prepare this report. For properties that prepare a limited scope engagement, the Agency may undertake random audits, once every two or three years.

(3) If a third party requires it, the borrower may have a CPA prepare an audit in accordance with generally accepted government auditing standards (GAGAS). Costs incurred to obtain this audit are an allowable project expense.

(b) *Engagement requirements.* Borrowers required to submit annual financial reports based on an engagement performed by a CPA must meet the following requirements:

(1) Borrowers must use an Agency approved engagement letter. Borrowers must submit the results of an engagement that examines specific records using agreed upon procedures established by the Agency and that describes the borrower's performance in meeting the standards described in paragraph (c) of this section.

(2) The engagement will be initiated by the borrower using the Agency's engagement letter, which will specify the engagement program and establish the reporting requirements for the engagement.

(3) The engagement must be conducted by a CPA in accordance with American Institute of Certified Public Accountant (AICPA) Standards and Agency requirements.

(4) All engagement reports must be prepared for use by the Agency.

(c) *Performance standards.* Borrowers must ensure that:

(1) Required accounts are properly maintained and tracked separately;

(2) Payments from operating accounts are disclosed and accurately represented on financial reports;

(3) The reserve amount is at the authorized level and there are no encumbrances;

(4) Tenant security deposit accounts are fully-funded and are maintained in separate accounts and meet state and local requirements;

(5) Amount of payment of owner return was consistent with the terms of the applicable loan agreement;

(6) The borrower has maintained proper insurance in accordance with the requirements of § 3560.105(b); and

(7) All financial records are adequate and suitable for examination.

(d) *Other financial reports.* (1) Nonprofit and public borrower entities must submit audits in accordance with 7 CFR part 3052 that must also include the requirements set forth in the limited scope engagement.

(2) The Agency may require additional opinions of financial condition and compliance, such as audits, to assure the security of the asset, determine whether the housing project is being operated at a reasonable cost, or to detect fraud, waste, or abuse.

(3) Any audits independently obtained by the borrower also must be submitted to the Agency.

OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, states in part:

Section 200:

(a) Audit required. Non-Federal entities that expend \$300,000 (\$500,000 for fiscal years ending after December 31, 2003) or

more in a year in Federal awards shall have a single or program-specific audit conducted for that year in accordance with the provisions of this part. Guidance on determining Federal awards expended is provided in §____.205.

(b) Single audit. Non-Federal entities that expend \$300,000 (\$500,000 for fiscal years ending after December 31, 2003) or more in a year in Federal awards shall have a single audit conducted in accordance with §____.500 except when they elect to have a program-specific audit conducted in accordance with paragraph (c) of this section.

Section 300:

The auditee shall:

(b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.

(c) Comply with laws, regulations, and the provisions of contracts or grant agreements related to each of its Federal programs.

(d) Prepare appropriate financial statements, including the schedule of expenditures of Federal awards in accordance with §____.310.

(e) Ensure that the audits required by this part are properly performed and submitted when due. When extensions to the report submission due date required by §____.320(a) are granted by the cognizant or oversight agency for audit, promptly notify the Federal clearinghouse designated by OMB and each pass-through entity providing Federal awards of the extension.

Section 320:

a) General. The audit shall be completed and the data collection form described in paragraph (b) of this section and reporting package described in paragraph (c) of this section shall be submitted within the earlier of 30 days after receipt of the auditor's report(s), or nine months after the end of the audit period, unless a longer period is agreed to in advance by the cognizant or oversight agency for audit.

Government Auditing Standards, July 2007 Revision, Section 5.11 states:

For all financial audits, auditors should report the following deficiencies in internal control:

a. Significant deficiency: a deficiency in internal control, or a combination of deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliability in accordance with GAAP such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected.

b. Material weakness: a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.