

Lambton County Community Services Housing Services Department Policy and Procedure Manual

SUBJECT: Financial Statement Review for Federal Providers	INDEX NO.: 1.025	
EFFECTIVE: October 1, 2001	APPROVED:	REVISED:

Policy:

Annually, the financial statements are reviewed according to the housing provider's operating agreement. Under these agreements, a financial statement review is conducted to ensure that the terms of the Operating Agreement are adhered to, including ensuring that no unauthorized rental increases have occurred and identifying project financial difficulties. Audited financial statements are due within four months of the project's fiscal year end or as stated in the Operating Agreement. Rental charges are reviewed at the time of financial statement review in order to assess if a project's rents are being determined appropriately.

Reviewing and Analyzing Financial Statements:

- Send reminder letter to housing provider the month following the year end, detailing due date and additional documentation required with financial statements.
- Prior to beginning a review:
- Ensure all related documents have been received including the following:
 - Annual Information Return (AIR);
 - management letter from the auditor;
 - confirmation of adherence to the ingoing income limit or low end of market rents;
 - auditor's confirmation with regard to funding of the replacement reserve fund and/or supplementary schedules for shelter/non-shelter component,
 - names, addresses and telephone numbers of owners.
- Review the following:
 - outstanding issues;
 - last physical inspection data;
 - approved expenditures from the replacement reserve fund;
 - previous financial review;
 - mortgage payment amount;
 - subsidy payments and RGI assistance amounts, if applicable.
- Request any outstanding information critical to the completion of the review.

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- Complete a preliminary review of the statements and record related information on the Financial Statement Review checklist (Form 3.019).
- Review the Auditor’s Report (Page 1 of the audited financial statements) to determine whether the statements are qualified. If they are, assess the reason for the qualification. If the qualification results simply from differences from GAAP (generally accepted accounting principles) as in CMHC’s treatment of depreciation, and the auditor notes that “except for this change the statements are fairly presented”, then accept after review. If the auditor is unable to present an opinion or gives an adverse opinion, the owner should be contacted immediately. If the financial statements are unaudited, confirm whether this is acceptable under the terms of the project’s Operating Agreement. For unaudited financial statements, the Service Manager should obtain a “Balance Sheet” and “Notes to the Financial Statements” as well as a “Statement of Revenue and Expenses”.
- Review the Revenue and Expense Statement.

Revenues

- Surpluses from commercial/retail operations are used to reduce operating deficits.
- Commercial space is to be rented at market rent, and normally surpluses are to be applied to reduce rent in the residential portion.
- Some projects include cable television and parking in the actual rents. Where there is a specific charge for these, they should be itemized separately in the statement of revenue.
- The cost of “free” rent for a janitor or superintendent is included in rental revenue.
- Municipal grants, provincial *per diem* or rent supplement amounts are included in revenue. Rent supplement amounts are usually identified separately in the financial statements.
- Verify actual vacancy dollars if there is a difference between actual rents collected and the rent potential.

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Expenses

- Verify that only the approved eligible mortgage payments are included. A review of the file will indicate whether there were any previously approved secondary encumbrances, and if so, whether they are considered eligible operating expenses.
- Verify subsidy provided during the fiscal year for accuracy, especially if the mortgage was renewed during that year. Ensure that the revised mortgage details were received and that subsidy was adjusted. If an erroneous calculation of subsidy was done, ensure that it is corrected immediately and any overpayment is recovered.
- Verify that the correct LEM rents were used to calculate the rent potential. A review of the file should confirm the rent effective date and the rents per bedroom type, which can be cross-checked to the Annual Project Data Report or its replacement. If it is not possible to reconcile the totals, or if vacancy losses appear significant, contact provider for rent roll or additional information.
- Administration includes office expenses (rent, telephone, stationery), salaries for management and office staff, professional property management (if applicable), advertisement and bank charges. Advertising may be considered a separate expense if a campaign is warranted because of high vacancies.
- Where a borrower is involved in other businesses or interests, or where the project has shelter/non-shelter operations, revenue and expenses pertaining to each should be segregated in the financial statements. Although the Service Manager's main interest is in the shelter operations, the overall project viability is a concern, since there may be early warning signs of future problems.
- Eligible operating expenses are property taxes, electricity, heat, water, maintenance and repair costs, insurance, janitor or superintendent, administration (normally limited to 6% of total expenses), principal and interest payments on the first mortgage (CMHC recognized principal repayment in lieu of depreciation), professional fees (legal, accounting, and audit), replacement reserve allocation approved by the Service Manager (better to include and note the under funded amount so that the total remains a liability to be recovered in case of sale), bad debt, capital tax, and interest

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on tenant deposits. Review for reasonableness; compare with prior year and area norms.

- A capital tax is levied by the province on capital through the corporate income tax return. The amount levied is a percentage of the company's capital structure which includes all sources of long-term or permanent financing, bank loans, advances from shareholders, capital stock, etc. Only the amount relevant to the project is to be allowed, if requested, as an eligible operating expense. Capital tax applies to most Ontario corporations but is calculated differently for different classes of corporations (e.g., small corporations pay no capital tax). Most non-profits will therefore not ask for it to be considered as an eligible operating expense.

- Review the Balance Sheet, Statement of Changes in Financial Position and Notes to the Financial Statements. Pay particular attention to Accounts Receivable and Payable, cash position or bank indebtedness, restricted cash and deposits, funded reserves, long-term debt and any other notes identifying secondary encumbrances or contingent liabilities.
- Review replacement reserve fund balance to determine whether there is any under funding and whether segregation of funds conforms to Operating Agreement guidelines.
- Assess the financial viability of the project. Determine whether there might be sufficient information to warrant a special inspection or an adjustment in the replacement reserve allocation.
- Review subsidy surplus balance, if applicable. If maximum fund balance has been reached and an operating surplus remains, request immediate remittance of the outstanding amount.
- Confirm annual assistance levels and / or disbursements.
- Draft a letter to the provider to confirm the results of the review, together with comments on outstanding issues. When necessary, attach a separate schedule showing changes from submitted amounts.
- Complete Financial Statement Review in Excel program and update information in POSH.