



FINANCIAL PERFORMANCE MONITORING

Day 3



LEAD THE WAY

PHA GOVERNANCE AND
FINANCIAL MANAGEMENT
A Training for Board Members and Staff



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Welcome to Day Three of *Lead the Way: PHA Governance and Financial Performance Monitoring*.

Who should complete this training?

This training is for all staff members of a public housing agency (PHA)—particularly those with any financial management responsibility. Typically this includes the Executive Director or the CEO, the Chief Financial Officer, Chief Operations Officer or administrator, other executive staff, program heads, including Housing Choice Voucher administrators, and any other staff interested or involved in the finances and oversight of the PHA. You may complete this course with your colleagues from your PHA, or with other PHAs in your region.

How long will it take to complete and how should we structure our time?

The entire training should be completed over the course of five days. We recommend that there be no more than one day between Days One through Three, and no more than one week between Days Three through Five. Sample agendas for each day are provided for your reference. These agendas are meant to provide a reference of how much time should be spent on each lesson. However, different groups will have different needs. If a group feels the need to spend more time on a particular topic, they should do so.

Are there knowledge checks or quizzes?

Pre- and post-tests are provided, so that the group has a sense of where they could improve their knowledge, and to provide a measurement of the knowledge obtained in the training. These may be used to assess completion if certificates of completion are included. You should have completed a pre-test for Days 1-3 on Day 1.

How is this training facilitated?

It is recommended that you have a leader and a coordinator to shepherd the group through the process of the training. The leader either takes on the role of lead instructor, or hires someone to do so. The coordinator helps to obtain space for the training, sets up registration, ensures that the facility is accessible to people with special needs, takes notes, and is available to answer questions throughout the day. Both the leader and participants will use the same Training Guide. Leaders should also look at the notes provided in the Day One slides.

Are there PowerPoint slides?

Slides are provided for use in the training. We have noted the corresponding slide for each topic area in the text. Remember that these slides are samples, and can be adjusted according to your needs.

How do I use this training guide?

Participants can use the training guides to review the material ahead of the training. Information provided in these guides provides helpful contextual information and background to what will be presented on the PowerPoint slides. Participants should also keep their guides with them during the training, and follow along with the slide numbers.

01 Financial Performance Monitoring

Agenda

8:30 a.m.	Check-In
8:45 a.m.	Module 1: Introduction to Financial Management Performance Monitoring Systems on page 5
10:30 a.m.	Break
10:45 a.m.	Module 2: Financial Performance Indicators and HUD Monitoring Data Systems on page 15
12:00 p.m.	Lunch
1:00 p.m.	Module 3: Assessing a Program's Financial Performance on page 22
2:15 p.m.	Break
2:30 p.m.	Module 4: Using Financial Information as a Planning Tool on page 28
4:00 p.m.	Class Ends

02 Module 1: Introduction to Financial Management Performance Monitoring Systems

Note: Slides 3-22 correspond with this module.

Module 1 Objectives

Day 3, Slide 4

At the conclusion of this module, you will understand:

- Key accounting concepts and terms
- Financial performance monitoring basics

Key Accounting Concepts

Day 3, Slides 5-7

Accounting is the language of finances and is used to communicate financial information. In order for financial information to make sense, accounting is based on fundamental concepts. These fundamental concepts form the basis for all of the Generally Accepted Accounting Principles (GAAP).

By understanding and applying these concepts, you will be able to read, prepare, and compare financial statements with clarity and accuracy. Further, your staff and external audiences do not need to make assumptions about the meaning of the numbers.

Key Accounting Formulas

Day 3, Slides 8-10

ASSETS – LIABILITIES = EQUITY

Assets: Property having value and available to meet debt or commitments

1. Current Assets—easily converted to cash (cash, cash equivalents, or inventory)
2. Tangible Assets—less easily converted to cash like computer equipment, buildings, and/or land depreciation

Liabilities are debts and obligations of the business. Liabilities are usually divided between current and long-term.

1. Notes payable
2. Accounts Payable
3. Interest Payable

Equity is the difference between the current market value of the property and the amount the owner still owes on the mortgage. The total value of an organization's assets is always equal to the combined value of its "equity" and "liabilities" on the balance sheet.

GROSS INCOME – EXPENSES = NET INCOME

Gross income includes any income you have accrued.

Net income is what remains after subtracting all of an organization's costs from its gross income. Net income is sometimes called the "bottom line" or "profit."

Gross income is before taxes and deductions, and net income is after taxes and deductions.

The terminology that will be used will depend on the type of organization (governmental, nonprofit, or private entity) and is determined by the application of Generally Accepted Accounting Principles (GAAP) by these various entities. HUD requires that all accounting records, including those for fixed assets, be kept using GAAP accounting as required by Uniform Financial Reporting Standards.

HUD required Multifamily owners to use GAAP to report the results of their operations. Effective for entities with fiscal years ending on or after December 31, 1998, 24 CFR Part 5, Subpart H requires that, on an annual basis, the financial information sent to HUD must be, "Prepared in accordance with Generally Accepted Accounting Principles as further defined by HUD in supplementary guidance."

Reference for Multifamily GAAP via Real Estate Assessment Center (REAC)

<http://www.hud.gov/offices/reac/pdf/3frag.pdf>

Reference for PHA: HUD PHA GAAP CONVERSION GUIDE January 31, 2000

http://portal.hud.gov/hudportal/documents/huddoc?id=DOC_26235.pdf

Federal Register

http://portal.hud.gov/hudportal/documents/huddoc?id=DOC_26327.pdf

Key Accounting Terms

Day 3, Slide 11

COST

"Cost," in this case, is a reference to the accounting principle that assets (something of value owned by the organization) are recorded in the accounting records at historical cost, that is, the price that was paid for them. However, in contrast, the "worth" of an asset changes over time due to the current fair market value price, including any depreciation assigned to a tangible asset.

ENTITY

Accounts are kept for entire organizations, not the people who own or run the entity.

TIME PERIOD

This concept defines a specific interval of time for which an entity's reports are prepared. This can be a fiscal year (FY), calendar year (Jan 1-Dec 31), or any other meaningful period, such as a quarter or a month.

OBJECTIVITY

The objectivity concept states that accounting will be recorded on the basis of objective evidence (invoices, receipts, bank statement, physical counts, electronic trails, etc.). This means that accounting records will initiate from a source document and that the information recorded is based on fact and not personal opinion. Objectivity makes it possible to compare financial statements of different organizations with an assurance of reliability and uniformity.

CONSISTENCY

Once an entity decides on one method of reporting, it must use that same method for all subsequent events. This ensures that differences in financial position between reporting periods are a result of changes in the operations and not to changes in the way items are accounted for.

CONSERVATISM

This requires understating, rather than overstating, revenue and expense amounts that have a degree of uncertainty. ***The rule is to recognize revenue when it is reasonably certain and recognize expenses as soon as they are reasonably possible.***

The reasons for accounting in this manner are so that financial statements do not overstate the company's financial position. Accounting chooses to err on the side of caution and protect an organization from inflated or overly positive results.

MONEY MEASUREMENT

An accounting record must be able to be expressed in monetary terms. For this reason, financial statements show only a limited picture of the business.

Financial Performance Monitoring Basics

Day 3, Slide 12

WHY FINANCIAL PERFORMANCE MONITORING?

Day 3, Slides 13-14

Any organization should monitor its own performance and make accurate and informed decisions about how to make things better. From a purely business sense of performance, outcomes should be measured as financial results.

Given that profit and cash flow are always on the minds of management, an organization should place particular emphasis on receiving regular financial performance reports.

THE IMPORTANCE OF FINANCIAL STATEMENTS

Day 3, Slide 15

At the end of a period—either annually or more frequently, depending on the length of an organization's accounting cycle—accountants create financial statements that show the entity's financial health (or decline).

Although FHA/HUD administers a wide variety of multifamily housing programs, participating owners fall into three general categories: profit-motivated, limited distribution, and nonprofit. The terms and conditions contained in an owner's Regulatory Agreement, Housing Assistance Payment Contract, HAP Assignment and Assumption document, Use Agreement, or other instructions found in a binding HUD business agreement and may vary, depending on the type the agreement for the multifamily program and/or ownership entity covered.

Accordingly, an owner's financial reporting requirements will also vary, based on these factors.

Most HUD programs require the submission of an annual audited financial statement from each participating owner for the purpose of ensuring that:

- The annual financial information presented to HUD is accurate.
- The owner's internal controls over financial reporting are operating effectively.
- The owner complies with the applicable HUD laws, regulations, and contract provisions associated with operating a multifamily property.

MANAGEMENT'S USE OF FINANCIAL PERFORMANCE MONITORING BASICS

Day 3, Slide 16

Managers use the data in financial statements to:

- Chart the course of their organizations
- Project revenues and expenses
- Monitor cash flow
- Keep tabs on costs and plan for the future
- Ensure books and records are maintained in accordance with HUD requirements
- Ensure that the annual financial information presented to HUD is accurate
- Ensure that the owner's internal controls over financial reporting are operating effectively
- Ensure that the owner complies with the applicable HUD laws, regulations, and contract provisions

FINANCIAL STATEMENTS

Day 3, Slide 17

There are three main components of financial statements include:

- Balance sheets
- Income statements
- Cash flow statements

HUD requires these basic financial statement components in the prescribed format for an electronic financial statement filing:

- Balance sheet
- Statement of income
- Statement of changes in partner's capital
- Statement of cash flows
- Footnotes to the basic financial statements, including descriptions of accounting policies

Reference

<http://www.hud.gov/offices/reac/pdf/3frag.pdf>

BALANCE SHEETS

Day 3, Slide 18

A balance sheet is a part of an organization's financial statements and lists the **assets, liabilities,** and **equity** of an organization at a specific point in time. Balance sheets are used to calculate net worth or equity. Think of a balance sheet as a "snapshot" of an organization's financial position at a given moment.

The balance sheet of an owning entity records the monetary value of the assets owned. Two major asset classes are tangible assets and intangible assets. Tangible assets contain various subclasses, including current assets and fixed assets. Current assets include inventory, while fixed assets include such items as buildings and equipment. Intangible assets are things like goodwill, covenants not to compete, franchise fees, organization costs, value placed on insurance renewals, and value placed on property management contract renewals.

INCOME STATEMENTS

Day 3, Slides 19-20

An income statement (also called a “statement of operations or earnings”) is another part of an organization’s financial statements. It shows the results of operations over a specific period of time called the “accounting period.” An accounting period can be a month, a quarter, a year, or any other period of the financial statement filed with HUD.

The results of operations are what cause the equity of the balance sheet to go up or down. If the organization has more revenue than expenses, it will have a profit and equity will go up. If the organization spends more than it has in revenue, it will have a loss, and equity will go down.

Profit or loss during the accounting period directly impacts the organization’s equity.

An important thing to remember about an income statement is that it represents a ***period*** of time. This contrasts with the balance sheet, which represents a ***single*** moment in time.

CASH FLOW STATEMENTS

Day 3, Slide 21

Cash flow statements (also called “statement of cash flows”) summarize the effects on cash of the operating, financing, and investing activities of an organization for an accounting period. Put more simply, it shows how the organization received its cash and how cash was used. For example, if the organization has been experiencing cash shortages, management can use the statement of cash flows to determine why such shortages are occurring. One reason could be that the organization is showing a loss (operating activities resulted in a loss). Losses will result in reductions in cash and profits (net income) will result in increases in cash. Another reason is that it used up its cash to purchase a major piece(s) of equipment (an investing activity).

The cash flow statement is ***distinct*** from the income statement and balance sheet because it does not include the amount of future incoming and outgoing cash.

Module 1 Knowledge Check

This knowledge check should be completed at the end of Module 1. Participants should circle their chosen answer. Leaders should review the correct answer using the following answer key once participants complete the knowledge check.

1. GAAP stands for:
 - a) General Accounting Assessment Principles
 - b) Generally Accepted Accounting Principles
 - c) General Account Acceptance Principles
2. Assets are what the organization owes.
 - a) True
 - b) False
3. Gross income is what remains after subtracting all of an organization's costs.
 - a) True
 - b) False
4. Accounts are kept for the people who own or run the entity.
 - a) True
 - b) False
5. Managers use the data in financial statements to:
 - a) Project revenues and expenses
 - b) Monitor cash flow
 - c) Keep tabs on costs and plan for the future
 - d) All of the above
6. The main components of financial statements are all but:
 - a) Balance sheets
 - b) Income statements
 - c) Revenue statements
 - d) Cash flow statements
7. The balance sheet represents:
 - a) The results of operations over an accounting period
 - b) A snapshot of an organization's financial position at a given point in time
 - c) The effects of cash on the operating, financing, and investing activities of an organization for an accounting period.
 - d) None of the above

8. The income statement represents:
 - a) The results of operations over an accounting period
 - b) A snapshot of an organization's financial position at a given point in time
 - c) The effects of cash on the operating, financing, and investing activities of an organization for an accounting period
 - d) None of the above
9. The cash flow statement represents:
 - a) The results of operations over an accounting period
 - b) A snapshot of an organization's financial position at a given point in time
 - c) The effects of cash on the operating, financing, and investing activities of an organization for an accounting period
 - d) None of the above
10. Profits or losses will directly impact the organization's equity and cash flow.
 - a) True
 - b) False

Stop: Do not proceed until the training Leader prompts you to turn the page.

Module 1 Knowledge Check

Answer key

Correct answers are indicated in **bold**.

1. GAAP stands for:
 - a) General Accounting Assessment Principles
 - b) **Generally Accepted Accounting Principles**
 - c) General Account Acceptance Principles
2. Assets are what the organization owes.
 - a) True
 - b) **False**
3. Gross income is what remains after subtracting all of an organization's costs.
 - a) True
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4. Accounts are kept for the people who own or run the entity.
 - a) True
 - b) **False**
5. Managers use the data in financial statements to:
 - a) Project revenues and expenses
 - b) Monitor cash flow
 - c) Keep tabs on costs and plan for the future
 - d) **All of the above**
6. The main components of financial statements are all but:
 - a) Balance sheets
 - b) Income statements
 - c) **Revenue statements**
 - d) Cash flow statements
7. The balance sheet represents:
 - a) The results of operations over an accounting period
 - b) **A snapshot of an organization's financial position at a given point in time**
 - c) The effects of cash on the operating, financing, and investing activities of an organization for an accounting period.
 - d) None of the above

8. The income statement represents:
- a) ***The results of operations over an accounting period***
 - b) A snapshot of an organization's financial position at a given point in time
 - c) The effects of cash on the operating, financing, and investing activities of an organization for an accounting period
 - d) None of the above
9. The cash flow statement represents:
- a) The results of operations over an accounting period
 - b) A snapshot of an organization's financial position at a given point in time
 - c) ***The effects of cash on the operating, financing, and investing activities of an organization for an accounting period***
 - d) None of the above
10. Profits or losses will directly impact the organization's equity and cash flow.
- a) ***True***
 - b) False

03 Module 2: Financial Performance Indicators and HUD Monitoring Data Systems

Note: Slides 23-62 correspond with this module.

Module 2 Objectives

Day 3, Slide 24

At the conclusion of this module, you will learn of:

- The calculation of Key Performance Indicators
- HUD's performance monitoring systems

Key Performance Indicators

Day 3, Slide 25

Key Performance Indicators (KPI) help an organization define and measure progress toward organizational goals. Key Performance Indicators are quantifiable measurements that reflect the critical success factors of an organization.

Once an organization has analyzed its mission, identified all of its stakeholders, and defined its goals, it needs a way to measure progress toward those goals. Key Performance Indicators are those measurements.

Ratios

Day 3, Slide 26

A ratio is a mathematical relationship between one quantity and another. A financial ratio is a comparison of one unit of financial information against another.

FOUR IMPORTANT RATIOS

Day 3, Slide 27

There are four aspects of an organization's financial posture that can be evaluated from ratios:

- Liquidity
- Activity
- Financial leverage
- Return on Investment Ratio (ROI)

LIQUIDITY RATIO

Day 3, Slides 28-30

A liquidity ratio is a class of financial metrics that is used to determine a company's ability to pay off its short-term debts and obligations. Generally, the higher the value of the ratio, the larger the margin of safety that the company possesses to cover short-term debts.

The rough rule of thumb for a liquidity ratio is 2:1. That is, for every \$1 of liabilities (within a 12-month period), there should be at least \$2 in current assets to meet such liabilities.

ACTIVITY RATIO

Day 3, Slide 31

An activity ratio is a metric that determines the ability of an organization to convert its balance sheet accounts into revenue. Activity ratios are critical in evaluating an organization's fundamentals because, in addition to expressing how well the organization generates revenue, activity ratios also indicate how well the company is being managed.

FINANCIAL LEVERAGE RATIO

Day 3, Slides 32-33

A leverage ratio calculates the financial leverage of an organization to ascertain the organization's methods of financing or to measure its ability to meet financial responsibilities. There are several different ratios here, but the main factors examined include debt, equity, assets, and interest expenses.

RETURN-ON-INVESTMENT RATIO (ROI)

Day 3, Slide 34

A Return on Investment (ROI) ratio measures the efficiency of an investment. To calculate ROI, the benefit (return) of an investment is divided by the cost of the investment. The result is expressed as a percentage or a ratio.

If a proposed investment does not have a positive ROI, or if there are other opportunities with a higher ROI, then the investment should be not be undertaken.

HUD Financial Performance Data Systems

Day 3, Slide 35

HUD has various financial performance data systems to monitor grantee financial progress in the Community Planning and Development, Public and Indian Housing, and Multifamily Housing programs.

COMMUNITY PLANNING AND DEVELOPMENT

Day 3, Slides 36-39

The Integrated Disbursement and Information System (IDIS) Online system is sponsored by the Office of Community Planning and Development (CPD). IDIS Online is a real-time, web-based computer application that provides financial disbursement, tracking, and reporting activities for the CPD formula grant programs.

These programs include the:

- Community Development Block Grant (CDBG) Program
- Emergency Shelter Grant (ESG) Program
- Housing Opportunities for Persons with AIDS (HOPWA) Program
- HOME Investment Partnerships Program (HOME)

IDIS Online enables HUD grantees to draw down program funds and report on the activities and accomplishments outlined in each jurisdiction's Consolidated Plan.

The system also allows grantees to request their grant funding from HUD and report on what is accomplished with these funds. To find out more about how to access and enter data into IDIS, go to: http://portal.hud.gov/hudportal/HUD?src=/program_offices/comm_planning/systems/idis/idis

PUBLIC AND INDIAN HOUSING

Day 3, Slides 40-41

PIH-Real Estate Assessment Center (REAC) designed the Financial Assessment Subsystem for Public Housing (FASS-PH) to financially assess public housing agencies (PHAs). FASS-PH helps measure the financial condition of PHAs and assesses their ability to provide safe and decent housing. FASS-PH also provides PIH-REAC with a complete database of the financial data of PHAs.

FINANCIAL DATA SCHEDULE (FDS)

Day 3, Slides 42-43

PHA financial information must be submitted to REAC electronically by the PHA through the FASS using a template known as the Financial Data Schedule (FDS). PHAs submit basic financial statements and certain auditor's reports electronically to REAC and maintain a hard copy of all financial statements and audit reports for three years.

The FDS was created in order to standardize the financial information reported by PHAs to HUD's REAC. REAC will use the FDS to analyze PHA financial data in conjunction with other performance measurements, to help ensure the success of PHA programs.

THE VOUCHER MANAGEMENT SYSTEM

Day 3, Slide 44

The Voucher Management System (VMS) supports the information management needs of the Housing Choice Voucher Program (HCVP) and management functions performed by the Financial Management Division (FMD) and the Financial Management Center (FMC) of Public and Indian Housing, as well as the Real Estate Management Center (PIH-REAC).

The primary purpose of the VMS is to monitor and manage PHA use of vouchers. VMS collects PHA data that enables HUD to fund, obligate, and disburse funding in a timely manner, based on actual PHA use.

MULTIFAMILY HOUSING

Day 3, Slides 45-62

The Real Estate Assessment Center (REAC) is responsible for collecting and assessing financial statements on multifamily projects and providing project managers with information concerning compliance deficiencies and performance risks.

Financial statements are collected from owners via the Internet and analyzed by REAC using a computer system called the Financial Assessment Subsystem (FASS).

HUD developed the Financial Assessment Subsystem-Multifamily Housing (FASS-MF) to improve the availability of annual financial data on housing projects funded throughout the agency. FASS-MF facilitates management and prioritization of the multifamily housing portfolio by performing automated assessments of the financial data and highlighting projects for which compliance deficiencies are identified.

FASS-MF is an automated system that supports the collection, validation, and assessment of financial data for multifamily housing properties insured and/or subsidized by HUD. The submissions are assessed for compliance and performance of the owning entity. The financial assessment measures the relative financial strength of a project and potential risks to HUD. Financial performance is measured by ratio analysis. Ratios highlight those properties that may be experiencing financial difficulty. Financial ratios may also act as an early warning signal of potential future compliance problems.

FASS-MF applies a statistical model that calculates the ratios as demonstrated on the PowerPoint slides. The model applies acceptable ranges of performance for each indicator and computes an overall point value, or performance risk rating. This rating can determine projects that may be a high financial risk for possible financial default and/or risk to the Federal Housing Administration (FHA) insurance fund.

The system checks for compliance issues are based on comparisons and calculations to ensure compliance with HUD Regulations and Business Agreements. The system checks compare data within the current year submission to data that were submitted in the prior year.

The financial performance ratios and the compliance checks provide data to the project manager about projects that may be performing at a marginal or unacceptable level. The project manager reviews every annual financial statement (AFS) and takes appropriate measures to work with the owner/agent to improve the financial condition of these projects.

The integrated approach through the use of FASS-MF performance ratio and compliance reviews assist HUD Multifamily in their long-term goal to expand access to availability and quality of affordable rental housing, improve owner/agent accountability, and improve housing opportunities for persons who are elderly or have disabilities.

Module 2 Knowledge Check

This knowledge check should be completed at the end of Module 2. Participants should circle their chosen answer. Leaders should review the correct answer using the following answer key once participants complete the knowledge check.

1. Key Performance Indicators are quantifiable measurements that reflect the critical success factors of an organization.
 - a) True
 - b) False
2. Important ratios include all but:
 - a) A liquidity ratio
 - b) An asset ratio
 - c) A financial leverage ratio
 - d) A Return on Investment Ratio (ROI)
3. The rough rule of thumb for a liquidity ratio is 3:1.
 - a) True
 - b) False
4. Community Planning and Development's financial performance monitoring system is:
 - a) The Integral Disbursement and Information System
 - b) The Integrated Disbursement and Data System
 - c) The Important Disbursement and Information System
 - d) The Integrated Disbursement and Information System
5. PIH-Real Estate Assessment Center (REAC) designed the Financial Assessment Subsystem for Public Housing (FASS-PH) to financially assess public housing agencies (PHAs).
 - a) True
 - b) False
6. FASS-MF is an automated system that supports the collection, validation, and assessment of financial data for multifamily housing properties insured and/or subsidized by HUD.
 - a) True
 - b) False

Stop: Do not proceed until the training Leader prompts you to turn the page.

Module 2 Knowledge Check

Answer Key

Correct answers are indicated in **bold**.

1. Key Performance Indicators are quantifiable measurements that reflect the critical success factors of an organization.
 - a) **True**
 - b) False
2. Important ratios include all but:
 - a) A liquidity ratio
 - b) **An asset ratio**
 - c) A financial leverage ratio
 - d) A Return on Investment Ratio (ROI)
3. The rough rule of thumb for a liquidity ratio is 3:1.
 - a) True
 - b) **False**
4. Community Planning and Development's financial performance monitoring system is:
 - a) The Integral Disbursement and Information System
 - b) The Integrated Disbursement and Data System
 - c) The Important Disbursement and Information System
 - d) **The Integrated Disbursement and Information System**
5. PIH-Real Estate Assessment Center (REAC) designed the Financial Assessment Subsystem for Public Housing (FASS-PH) to financially assess public housing agencies (PHAs).
 - a) **True**
 - b) False
6. FASS-MF is an automated system that supports the collection, validation, and assessment of financial data for multifamily housing properties insured and/or subsidized by HUD.
 - a) **True**
 - b) False

04 Module 3: Assessing a Program's Financial Performance

Note: Slides 63-86 correspond with this module.

Module 3 Objectives

Day 3, Slide 64

At the conclusion of this module, you will understand:

- Causes of financial performance problems
- Management's responsibility in the face of financial performance problems

Why Evaluate Financial Performance?

Day 3, Slides 65-67

Evaluating financial performance is an essential tool for PIH, Multifamily, and CPD, aimed at monitoring performance and assessing risk where program participants have a business requirement to file financial statements.

Poor financial performance can serve as an indicator that something is wrong within your organization. For instance, if your organization is incurring a loss, it may be because you're overspending for certain items or expenses. Having this information, you can make an informed decision to find ways to reduce and/or control cost (e.g., re-bid for the services).

Three Methods for Evaluating Financial Performance

OPERATING STATEMENTS

Day 3, Slide 68

An operating statement, also known as an "income statement" or a "profit and loss statement," is a financial statement showing a company's net income or net loss for a specified period of time. If prepared periodically, these useful tools can signal a small or large budget variance.

MONTHLY FINANCIAL REPORTS WITH VARIANCES

Day 3, Slide 69

A variance report is a way for an organization to gauge its company's performance by comparing a planned amount to an actual amount. Organizations consistently use variance reports to analyze if they've met their budgetary goals for the month.

In challenging economic times, it is important for an organization to carefully monitor overspending and underspending. If there is a trend towards either, the entire budget may need to be revisited.

PROJECT-BASED BUDGETS

Day 3, Slide 70

Project-based budgets are operating budgets that are completed at the project level, as opposed to on an organization-wide basis. Primarily, project-based budgets are used for internal planning purposes.

On Day Four, we will cover how you prepare a project-based budget.

Causes of Financial Performance Problems

Day 3, Slide 71

There are many causes of financial performance problems. In this section, we cover some, including management's responsibility in light of these problems.

GENERAL LACK OF MANAGEMENT AND ACCOUNTABILITY

Day 3, Slide 72

When management fails to manage financial performance problems and subsequently be held accountable for the same, an organization is ripe for deficiencies.

MISAPPROPRIATION OF FUNDS

Day 3, Slide 73

Misappropriation of funds is when an employee with a fiduciary duty to protect the organization uses the organization's financial resources illegally, or for another unauthorized purpose.

Management's Role

Day 3, Slide 74

If financial managers do not implement a "checks and balances" system, the misappropriation of funds is more likely to happen and, in the worst-case scenario, go unnoticed until an audit is conducted.

COMMINGLING FUNDS

Day 3, Slides 75-76

Commingling is the act of mixing the funds belonging to one party with those of another party, especially when one party has the responsibility to keep the funds separate from the other party.

Recipients and subrecipients are prohibited from commingling funds on either a program-by-program or project-by-project basis. In the public housing program, funds specifically budgeted and/or received for one project may not be used to support another project, except to the extent the project has excess cash.¹

Management's Role

Day 3, Slide 77

Where a recipient's or subrecipient's accounting system cannot comply with this requirement, management must establish a system to provide adequate fund accountability for each project it has been awarded—or face recapture.

POOR INTERNAL CONTROLS

Day 3, Slides 78-79

In a HUD General Accounting Office (GAO) report, it was noted that poor internal controls resulted in questionable expenses. More specifically, the GAO found that significant internal control weaknesses in HUD's approximately \$10.6 million purchase card program resulted in improper, potentially improper, and questionable purchases.

These weaknesses created an environment in which improper purchases could be made with little risk of detection and likely contributed to the \$2.3 million in improper, potentially improper, and questionable purchases GAO identified.

Management's Role

Day 3, Slide 80

Management is responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations. Management shall consistently apply the internal control standards to meet each of the internal control objectives and to assess internal control effectiveness.

FRAUD, WASTE, & ABUSE

Day 3, Slides 81

In PIH programs, HUD's Office of Inspector General (OIG) is responsible for conducting investigations in all programs of the Department to include PHA fraud, waste, and abuse.

Management's Role

Day 3, Slide 82

Unlike other law enforcement agencies, OIG is a part of the Department's management and has a vested interest in maintaining the integrity of Departmental programs.

¹ Under the Assessment Management provisions of the Operating Fund Rule, projects are allowed to transfer excess cash from one public housing project to another. The determination of whether a project has excess cash is primarily a balance sheet calculation. The calculation of excess cash is made based on the previous year's year-end balance sheet.

POOR MANAGEMENT OF PROGRAM INCOME

Day 3, Slide 83

Program income is income earned by a HUD grant recipient from activities that are supported by the direct costs of its award. HUD prescribes what a grant recipient must do if it earns program income.

Management's Role

Day 3, Slide 84

Management is responsible for being knowledgeable about HUD's restrictions regarding the use of program income. Therefore, it is management's role to implement policies and procedures that ensure proper HUD program income uses.

The Impact of Financial Performance Problems

Day 3, Slide 85

Financial performance problems can lead to poor audit findings, sanctions, or funds recapture. Implementing the strategies and techniques learned over the past three days will greatly reduce the likelihood of financial performance problems in your organization.

Module 3 Knowledge Check

This knowledge check should be completed at the end of Module 3. Participants should circle their chosen answer. Leaders should review the correct answer using the following answer key once participants complete the knowledge check

1. Operating statements show how an organization operates on a day-to-day basis.
 - a) True
 - b) False
2. Recipients and subrecipients are allowed to commingle funds on either a program-by-program or project-by-project basis.
 - a) True
 - b) False
3. A variance report is a way for an organization to gauge its company's performance by comparing a planned amount to an actual amount.
 - a) True
 - b) False
4. Primarily, project-based budgets are used for external planning purposes.
 - a) True
 - b) False
5. When an employee with a fiduciary duty to protect the organization uses the organization's financial resources illegally, it is called:
 - a) Usurpation
 - b) Appropriation
 - c) Misappropriation
6. HUD grantees can commingle funds on a program-by-program basis only.
 - a) True
 - b) False

Stop: Do not proceed until the training Leader prompts you to turn the page.

Module 3 Knowledge Check

Answer Key

Correct answers are indicated in **bold**.

1. Operating statements show how an organization operates on a day-to-day basis.
 - a) True
 - b) **False**
2. Recipients and subrecipients are allowed to commingle funds on either a program-by-program or project-by-project basis.
 - a) True
 - b) **False**
3. A variance report is a way for an organization to gauge its company's performance by comparing a planned amount to an actual amount.
 - a) **True**
 - b) False
4. Primarily, project-based budgets are used for external planning purposes.
 - a) True
 - b) **False**
5. When an employee with a fiduciary duty to protect the organization uses the organization's financial resources illegally, it is called:
 - a) Usurpation
 - b) Appropriation
 - c) **Misappropriation**
6. HUD grantees can commingle funds on a program-by-program basis only.
 - a) True
 - b) **False**

05 Module 4: Using Financial Information as a Planning Tool

Note: Slides 87-100 correspond with this module.

Module 4 Objectives

Day 3, Slide 88

At the conclusion of this module, you will understand:

- Strategic planning using financial data

The Key to Good Strategic Planning

Day 3, Slide 90

FINANCIAL INFORMATION AS A PLANNING TOOL

A good strategic plan includes metrics that translate the organization's vision and mission into specific end points. This is critical because strategic planning is ultimately about financial and other resource allocation.

Financial metrics have long been the standard for assessing an organization's performance. These metrics support the role of finance in establishing and monitoring specific and measurable financial strategic goals on a coordinated, integrated basis. This allows the organization to operate efficiently and effectively.

HUD AGENCY'S MISSION AND POLICY DECISIONS

Day 3, Slides 91-95

From the grantee level up to HUD's CFO, the Agency uses key financial information when formulating its mission. HUD, in turn, makes policy decisions that directly support this mission, utilizing data gleaned from viewing the entire financial picture of the organization.

Examples of HUD Long-term vs. Short-term Goals

Day 3, Slide 96

Long-term Goals

Day 3, Slide 97

Goal 1: Strengthen the Nation's Housing Market To Bolster the Economy and Protect Consumers

Reduce the average residential vacancy rate in Neighborhood Stabilization Program (NSP) investment areas.

Goal 2: Meet the Need for Quality Affordable Rental Homes

Increase the total number of affordable rental homes constructed and rehabilitated in communities with the greatest unmet needs.

Goal 3: Utilize Housing as a Platform for Improving Quality of Life

Provide access to information and opportunities by increasing the proportion of units in HUD public and multifamily housing with an available broadband Internet connection.

Goal 4: Build Inclusive and Sustainable Communities Free From Discrimination

Prioritize energy efficiency through HUD programs. Expand and enhance market-based financing mechanisms to leverage private sector investments in energy efficiency and renewable energy.

Goal 5: Transform the Way HUD Does Business

Create a performance plan and define expectations.

SHORT-TERM GOAL

Day 3, Slide 98

Goal 1

Simplifying financial programs and burdensome administrative requirements for PHAs.

Exercise in Setting Long-Term and Short-Term Goals

Day 3, Slide 101

Directions: Divide class participants into their programs areas. Invite program participants to review HUD's performance goals listed above and to reflect on how the grant funds they receive from HUD programs assists HUD and their communities by:

Identifying long-term goals of your program area:

1. Long-Term Goal 1 (CPD)

2. Long-Term Goal 2 (Multifamily)

3. Long-Term Goal 3 (PIH)

Now, taking these into account, identify three short-term goals to implement one of the above long-term goals.

1. Short-Term Goal 1

2. Short-Term Goal 2

3. Short-Term Goal 3

Appendix: Day 3 Checklist—Financial Performance Monitoring

1. **Accounting:**

- ✓ Is the language of finances
- ✓ Is used to communicate financial information
- ✓ Is based on fundamental concepts

These fundamental concepts form the basis for all of the Generally Accepted Accounting Principles (GAAP).

2. **Key accounting formulas** include:

- ✓ $\text{Assets} - \text{Liabilities} = \text{Profit}$
- ✓ $\text{Gross Income} - \text{Expenses} = \text{Net Income}$

3. **Cost:** A cost is an asset (something that is owned by the organization) entered into the accounting records at the price paid to acquire it.

4. **Entity:** Accounts are kept for entire organization, not the people who own or run the entity

5. **Time Period:** This concept defines a specific interval of time for which an entity's reports are prepared.

6. **Objectivity:** Accounting will be recorded on the basis of objective evidence (invoices, receipts, bank statement, etc.).

7. **Consistency:** Once an entity decides on one method of reporting, it must use that same method for all subsequent events.

8. **Conservatism:** Conservatism requires understating, rather than overstating, revenue and expense amounts that have a degree of uncertainty.

9. **Money Measurement:** An accounting record must be able to be expressed in monetary terms. For this reason, financial statements show only a limited picture of the business.

10. **Financial performance monitoring is important** because:

- ✓ From a purely business sense of performance, outcomes should be measured as financial results.

11. **Effective implementation of internal controls** gives reasonable assurance—not a guarantee—that all of the organization's business objectives will be achieved.

12. **Managers use the data in financial statements** to:

- ✓ Chart the course of their organizations
- ✓ Project revenues and expenses
- ✓ Monitor cash flow
- ✓ Keep tabs on costs and plan for the future

13. There are **three main types of financial statements**:

- ✓ Balance sheets
- ✓ Income statements
- ✓ Cash flow statements

14. **Balance sheets** are:

- ✓ Financial statements that list the **assets, liabilities**, and **profits** of an organization at a specific point in time
- ✓ Used to calculate net worth

15. **Income statements** show:

- ✓ How much money an organization made over a period of time
- ✓ How much money was spent over a period of time

16. **Cash flow statements** show the exchange of money between an organization and the outside world over a period of time.

17. **Key Performance Indicators (KPI)**:

- ✓ Help an organization define and measure progress toward organizational goals
- ✓ Are quantifiable measurements that reflect the critical success factors of an organization
- ✓ Measure an organization's mission and identified stakeholders, and defines its goals

18. A **ratio** is a mathematical relationship between one quantity and another.

A financial ratio is a comparison of one unit of financial information against another

19. There are **four important ratios**:

- ✓ A liquidity ratio
- ✓ An activity ratio
- ✓ A financial leverage ratio
- ✓ A Return on Investment Ratio (ROI)

20. A **liquidity ratio** is a class of financial metrics that is used to determine a company's ability to pay off its short-term debts and obligations.

Generally, the higher the value of the ratio, the larger the margin of safety that the company possesses to cover short-term debts.

The rough rule of thumb for a liquidity ratio is 2:1.

21. An **activity ratio** is:

- ✓ A metric which determines the ability of an organization to convert its balance sheet accounts into revenue

Activity ratios are critical in evaluating an organization's fundamentals.

22. A **financial leverage** ratio:

- ✓ Calculates the financial leverage of an organization to ascertain the organization's methods of financing or to measure its ability to meet financial responsibilities

There are several different ratios here, but the main factors examined include debt, equity, assets, and interest expenses.

23. A **Return on Investment (ROI)** ratio:

- ✓ Measures the efficiency of an investment

To calculate ROI, the benefit (return) of an investment is divided by the cost of the investment. The result is expressed as a percentage or a ratio.

If a proposed investment does not have a positive ROI, or if there are other opportunities with a higher ROI, then the investment should be not be undertaken.

24. The **Integrated Disbursement and Information System (IDIS)** Online system:

- ✓ Is sponsored by the Office of Community Planning and Development (CPD)
- ✓ Is a real-time, web-based computer application that provides financial disbursement, tracking, and reporting activities for the CPD formula grant programs

25. **PIH-Real Estate Assessment Center (REAC):**

- ✓ Designed the Financial Assessment Subsystem for Public Housing (FASS-PH) to financially assess public housing agencies (PHAs)
- ✓ FASS-PH helps measure the financial condition of PHAs and assesses their ability to provide safe and decent housing
- ✓ FASS-PH also provides PIH-REAC with a complete database of the financial data of PHAs

26. HUD has developed the **Financial Assessment Subsystem—Multifamily Housing (FASSMF):**

- ✓ To improve the availability of annual financial data on housing projects funded throughout the agency
- ✓ To facilitate management and prioritization of the multifamily housing portfolio by performing automated assessments of the financial data and highlighting projects for which compliance deficiencies are identified
- ✓ To support the collection, validation, and assessment of financial data for multifamily housing properties insured and/or subsidized by HUD

27. An **operating statement**, also known as an “income statement” or a “profit and loss statement,” is a financial statement showing a company's net income or net loss for a **specified period of time**. If prepared periodically, these useful tools can signal a small or large budget variance.

28. A **variance report** is a way for an organization to gauge its performance by comparing a planned amount to an actual amount. Organizations consistently use variance reports to analyze if they've met their budgetary goals for the month.

29. **Project-based budgets** are operating budgets that are completed at the project level, as opposed to on an organization-wide basis. Primarily, project-based budgets are used for internal planning purposes.

30. An **organization is ripe for deficiencies** if:

- ✓ Management fails to manage financial performance problems and be held accountable for the same

31. **Misappropriation of funds** is:

- ✓ When an employee with a fiduciary duty to protect the organization uses the organization's financial resources illegally or for another unauthorized purpose

If financial managers do not implement a "checks and balance" system, the misappropriation of funds is more likely to happen.

32. **Commingling** is:

- ✓ The act of mixing the funds belonging to one party with those of another party, especially when first party has responsibility to keep the funds separate from the other party

Recipients and subrecipients are prohibited from commingling funds on either a program-by-program or project-by-project basis. In addition, funds specifically budgeted and/or received for one project may not be used to support another.

Where a recipient's or subrecipient's accounting system cannot comply with this requirement, management must establish a system to provide adequate fund accountability for each project it has been awarded.

33. **Fraud, waste, and abuse**

- ✓ In PIH programs, HUD's Office of Inspector General (OIG) is responsible for conducting investigations in all programs of the Department to include PHA fraud, waste, and abuse.
- ✓ Unlike other law enforcement agencies, OIG is a part of the Department's management and has a vested interest in maintaining the integrity of Departmental programs.

34. **Program income:**

- ✓ Is income earned by a HUD grant recipient from activities which are supported by the direct costs of their award

HUD prescribes what a grant recipient must do if it earns program income.

Management is responsible for being knowledgeable about HUD's restrictions regarding the use of program income.

35. **The key to good strategic planning:**

- ✓ A good strategic plan includes metrics that translate the organization's vision and mission into specific end points.
- ✓ This is critical because strategic planning is ultimately about financial and other resource allocation and would not be relevant if resources were unlimited.

- ✓ From the grantee level up to HUD's CFO, the Agency uses key financial information when formulating its mission.
- ✓ HUD, in turn, makes policy decisions that directly support this mission, utilizing data gleaned from viewing the entire financial picture of the organization.

36. **Long-term financial goals:**

- ✓ Need more financial resources and are more difficult to calculate (vs. short-term goals)
- ✓ Must be on management's minds constantly so that the organization works steadily and consistently

37. **Short-term financial goals:**

- ✓ Expect accomplishment in a short period of time
- ✓ Need not relate to any specific length of time

The time-frame for a short-term financial goal relates to its context in the overall financial timeline that it is being applied to. For instance, one could measure a short-term goal for years (such as in HUD's Strategic Plan for Fiscal Years 2010-2015).