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Auditors' reports under U.S. Department of Housing and Urban Development's Audit guide for mortgagors having HUD insured or Secretary held multifamily mortgages; Statement of position 90-04;

American Institute of Certified Public Accountants. Auditing Standards Division

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**Statement of
Position**

90-4

**Auditors' Reports Under
U.S. Department of Housing
and Urban Development's
*Audit Guide for Mortgagors
Having HUD Insured
or Secretary Held
Multifamily Mortgages***

February 23, 1990

**Issued by
Auditing Standards Division**

**American Institute of
Certified Public Accountants**

AICPA

NOTE

This statement of position presents the recommendations of the staff of the AICPA Auditing Standards Division regarding the application of generally accepted auditing standards to reports issued in audits done in accordance with the United States Department of Housing and Urban Development's *Audit Guide for Mortgagors Having HUD Insured or Secretary Held Multifamily Mortgages* (Handbook IG 4372.1 REV. — 2-88). It has been reviewed by members of the AICPA Auditing Standards Board for consistency with existing auditing standards. AICPA members may have to justify departures from the recommendations in this statement if their work is challenged.

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Auditors' Reports Under U.S. Department of Housing and Urban Development's Audit Guide for Mortgagors Having HUD Insured or Secretary Held Multifamily Mortgages

Introduction

1. In February 1988 the U.S. Department of Housing and Urban Development (HUD) issued *Audit Guide for Mortgagors Having HUD Insured or Secretary Held Multifamily Mortgages* (Handbook IG 4372.1 REV. —2-88).¹ Appendix 1 to that guide presented illustrations of auditors' reports on financial statements and on compliance and internal controls. In April 1988, the AICPA's Auditing Standards Board issued Statement on Auditing Standards (SAS) No. 58, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 508), which changes the auditor's standard report on financial statements, and SAS No. 60, *Communication of Internal Control Structure Related Matters Noted in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 325), which changes the auditor's report on internal controls. In July 1988, the U.S. General Accounting Office issued a revised version of *Government Auditing Standards*, which changes the way auditors report on compliance with laws and regulations and on internal control. Further guidance on reporting in accordance with the revised *Government Auditing Standards* was provided in SAS No. 63, *Compliance Auditing Applicable to Governmental Entities and Other Recipients of Governmental Financial Assistance* (AICPA, *Professional Standards*, vol. 1, AU sec. 801), issued in April 1989.

¹This guide (stock number 023-000-00726-6) can be obtained from the Government Printing Office (GPO) for \$2.75. Other available HUD guides include HUD Handbook IG 4000.3 REV-2-12-88, a guide for audits of HUD-approved nonsupervised mortgagees, loan correspondents, and coinsuring mortgagees (stock no. 023-000-00718-5), priced at \$2.50, and HUD Handbook IG 4200.1A-3-78, an audit guide for development costs of HUD-insured multifamily projects (023-000-00728-2) priced at \$2.25. Write to the Superintendent of Documents, GPO, Washington, D.C. 20402 or call (202) 783-3238 for credit card orders.

2. This statement illustrates auditors' reports on financial statements, on compliance with laws and regulations, and on the internal control structure that satisfy the requirements of HUD's *Audit Guide for Mortgagors Having HUD Insured or Secretary Held Multifamily Mortgages* and of SAS Nos. 58, 60, and 63.

Auditors' Reports

3. The following are illustrations of auditors' reports on financial statements, on compliance with laws and regulations, and on the internal control structure that may be issued in an audit in accordance with HUD's *Audit Guide for Mortgagors Having HUD Insured or Secretary Held Multifamily Mortgages*. Auditors should exercise professional judgment in tailoring these reports to the circumstances of individual audits. Guidance on modifications to reports on financial statements is included in SAS No. 58. Guidance on modifications to reports on compliance and on the internal control structure is included in SAS No. 63.

Report on Audited Financial Statements

Independent Auditor's Report

To the Partners
ABC Partnership
Anytown, U.S.A.:

We have audited the accompanying balance sheet of HUD Project No. 075-44001 of the ABC Partnership (a limited partnership) as of June 30, 198X, and the related statements of income and expense and changes in partners' equity and cash flows for the year then ended. These financial statements are the responsibility of the project's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 HUD Project No. 075-44001 as of June 30, 198X, and the results of its operations and the changes in partners' equity and cash flows for the year then ended in conformity with generally accepted accounting principles.

Our audit was made for the purpose of forming an opinion on the financial statements taken as a whole. The supporting data included in the report (shown on pages XX to XY) are presented for the purposes of additional analysis and are not a required part of the financial statements of HUD Project No. 075-44001. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

XYZ and Company
Certified Public Accountants

Anytown, U.S.A.
[Date]

**Report on Compliance With Laws and Regulations
(No Material Noncompliance Noted)**

To the Partners
ABC Partnership
Anytown, U.S.A.:

We have audited the financial statements of HUD Project No. 075-44001 of the ABC Partnership (a limited partnership) as of and for the year ended June 30, 198X, and have issued our report thereon dated [date of report]. We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws, regulations, contracts, and grants applicable to the project is the responsibility of the project's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the project's compliance with certain provisions of laws, regulations, contracts, and grants. However, our objective was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

We also considered those compliance matters comprehended in the "Audit Compliance and Internal Control Questionnaire," which is set forth in Appendix 2 of the U.S. Department of Housing and Urban Development (HUD) *Audit Guide for Mortgagees Having HUD Insured or Secretary Held Multifamily Mortgages*.

The results of our tests indicate that, with respect to the items tested, the project complied, in all material respects, with the provisions referred to in the preceding two paragraphs. With respect to the items not tested, nothing came to our attention that caused us to believe that the project had not complied, in all material respects, with those provisions.²

²If the audit disclosed conditions that the auditor considers to be privileged and confidential information as described in chapter 5, paragraphs 28 through 31, of *Government Auditing Standards*, language such as the following should be added to the auditor's report on compliance:

Our audit also disclosed certain conditions that we considered to be privileged information not appropriate for this report. In accordance with prescribed standards of the Department of HUD, these conditions will be reported in separate letters to the addressees of this report. We considered these conditions in forming our opinion on whether the project's 198X financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles, and this report does not affect our report dated [date of report] on those financial statements.

This report is intended for the information of the audit committee, management, and the Department of HUD.

XYZ and Company
Certified Public Accountants

Anytown, U.S.A.
[Date]

**Report on Compliance With Laws and Regulations
(Material Noncompliance Noted)**

To the Partners
ABC Partnership
Anytown, U.S.A.:

We have audited the financial statements of HUD Project No. 075-44001 of the ABC Partnership (a limited partnership) as of and for the year ended June 30, 198X, and have issued our report thereon dated [date of report]. We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws, regulations, contracts, and grants applicable to the project is the responsibility of the project's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the project's compliance with certain provisions of laws, regulations, contracts, and grants. However, our objective was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

We also considered those compliance matters comprehended in the "Audit Compliance and Internal Control Questionnaire," which is set forth in Appendix 2 of the U.S. Department of Housing and Urban Development (HUD) *Audit Guide for Mortgagees Having HUD Insured or Secretary Held Multifamily Mortgages*.

Material instances of noncompliance are failures to follow requirements, or violations of prohibitions, contained in statutes, regulations, contracts, or grants, that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the financial statements. The results of our tests of compliance disclosed the following material instances of noncompliance, the effects of which have been corrected in the project's 198X financial statements.

[Include paragraphs describing the material instances of noncompliance noted.]

We considered these material instances of noncompliance in forming our opinion on whether the project's 198X financial statements are

presented fairly, in all material respects, in conformity with generally accepted accounting principles, and this report does not affect our report dated [*date of report*] on those financial statements.

Except as described above, the results of our tests of compliance indicate that, with respect to the items tested, the project complied, in all material respects, with the provisions referred to in the second and third paragraphs of this report, and with respect to items not tested, nothing came to our attention that caused us to believe that the project had not complied, in all material respects, with those provisions.³

This report is intended for the information of the audit committee, management, and the Department of HUD.

XYZ and Company
Certified Public Accountants

Anytown, U.S.A.
[*Date*]

³See footnote 2.

Report on the Internal Control Structure

To the Partners
ABC Partnership
Anytown, U.S.A.:

We have audited the financial statements of HUD Project No. 075-44001 of the ABC Partnership (a limited partnership) as of and for the year ended June 30, 198X, and have issued our report thereon dated [date of report]. We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit of the financial statements of HUD Project No. 075-44001 of the ABC Partnership (a limited partnership) for the year ended June 30, 198X, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control structure.

In connection therewith, we have also made a study of those internal accounting control and administrative control procedures comprehended in the "Audit Compliance and Internal Control Questionnaire," which is set forth in Appendix 2 of the U.S. Department of Housing and Urban Development (HUD) *Audit Guide for Mortgagors Having HUD Insured or Secretary Held Multifamily Mortgages*. Our study included tests of compliance with such procedures.

The management of the project is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures in the following categories [*identify internal control structure categories*].

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.⁴

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants.⁵ Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

[*Include paragraphs to describe the reportable conditions noted.*]

A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

⁴This description of the scope of the auditor's consideration of the internal control structure is based on the provisions of SAS No. 55, *Consideration of the Internal Control Structure in a Financial Statement Audit*. This description should not be used if the auditor has not implemented SAS No. 55. Rather, the description of the scope of the auditor's work should be based on the provisions of SAS No. 1, AU section 320, "The Auditor's Study and Evaluation of Internal Control." Following is an example of such a description:

Our consideration of the internal control structure included all of the control categories listed above except that we did not evaluate the internal control structure over [*identify any category not evaluated*] because [*state reasons for excluding any category from the evaluation*]. The purpose of our consideration of the internal control structure was to determine the nature, timing, and extent of the auditing procedures necessary for expressing an opinion on the financial statements.

If the auditor has not made a study and evaluation of any significant category of the internal control structure beyond the preliminary review phase described in AU section 320.53–55, a description of the scope of the auditor's work, such as the following, should be used:

Solely to assist us in planning and performing our audit, we made a study and evaluation of the internal control structure of HUD Project No. 075-44001 of the ABC Partnership (a limited partnership). That study and evaluation was limited to a preliminary review of the structure to obtain an understanding of the control environment and the flow of transactions through the accounting system. Because [*state reason*], our study and evaluation did not extend beyond this preliminary review phase.

⁵Paragraph 39 of SAS No. 63 provides guidance on reporting when the auditor notes no reportable conditions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described above is a material weakness.

We also noted other matters involving the internal control structure and its operation that we have reported to the management of the project in a separate communication dated September 8, 198X.

We understand that (1) the objectives of the control procedures referred to in the third paragraph of this report are to provide assurance concerning compliance with HUD's related requirements, (2) such procedures are considered by HUD to be adequate for its purposes in accordance with the National Housing Act and related regulations, and (3) procedures that do not accomplish such objectives indicate some inadequacy for such purposes. Based on this understanding and on our study, we believe that the project's procedures would be adequate for such purposes.

This report is intended for the information of the audit committee, management, and the Department of HUD.

XYZ and Company
Certified Public Accountants

Anytown, U.S.A.
[Date]

Effective Date

4. This statement is effective for reports issued on or after April 1, 1990, with early application permissible.

