

# Real Estate Assessment Center



## Summary of Financial Reporting and Auditing Guidance for HUD Multifamily Program Participants and Independent Auditors

Revised February 19, 2003

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## List of Abbreviations Used

The following defines the abbreviations found throughout this guide:

AFS	Annual financial Statement
FASS	Financial Assessment Subsystem
FHA	Federal Housing Administration
HUD	U.S. Department of Housing & Urban Development
HAP	Housing Assistance Payment
OIG	Office of Inspector General
OMB	Office of Management and Budget

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## Introduction: Background and Purpose of the Guide

### 1.1 Background

The U.S. Department of Housing and Urban Development's (HUD) Office of Housing/Federal Housing Administration (FHA) administers a variety of programs to increase the supply of affordable low- and moderate-income multifamily housing stock. Most of those programs require the submission of an annual audited financial statement from each participating owner for the purpose of assuring that:

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

The Real Estate Assessment Center (REAC) is responsible for collecting and assessing financial statements on multifamily projects and providing project managers 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).

Historically, FHA prescribed the accounting and annual financial reporting requirements for most multifamily program participants<sup>1</sup>. Separately, HUD's Office of Inspector General (IG) provides Certified Public Accountants (CPAs) with multifamily program accounting and audit guidance<sup>2</sup>. Further complicating matters, the Office of Management and Budget's (OMB) Circular A-133 (and associated Compliance Supplement) presents audit guidance to CPAs conducting audits of certain non-profits participating in FHA/HUD multifamily programs.

The type of submission and whether a submission is required of an owner is not dependent on the type of program, but is dependent on the type of owner and their Business Agreement.

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<sup>1</sup>The majority of those requirements were summarized in HUD Handbook 4370.2 REV-1 (5/22/92)– *Financial Operations and Accounting Procedures for Insured Multifamily Projects*.

<sup>2</sup> Those requirements are contained in HUD Handbook 2000.04 REV-2 CHG-1 – *Consolidated Audit Guide for Audits of HUD Programs*. Chapter 4 of that guide is included in this document in its entirety as a matter of convenience to the reader.

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## 1.2 Purpose

The purpose of this guide is to present, in one document, the accounting, annual financial reporting and auditing requirements for FHA/HUD multifamily program participants. Project owners, their property managers, and their independent auditors should use this document as a reference guide. This guide does not replace or promulgate accounting principles or professional auditing standards<sup>3</sup>. Rather, it summarizes FHA/HUD's multifamily program requirements in a concise, easy to follow format. Owners, property managers and their independent auditors should refer to the professional literature cited in this guide for the relevant accounting, financial reporting and auditing standards.

Chapter 2 contains accounting, record keeping, and compliance requirements for covered MF program participants based on HUD's Business Agreements. Chapter 3 contains reporting requirements and issues for various mortgagor types and filing options based on the Regulatory Agreement, OMB Circular A-133 and REAC's Industry Users Guide. Chapter 4 contains audit guidance from The HUD Consolidated Audit Guide and other associated authoritative literature. Chapter 5 contains requirements for the attestation of the electronic version of the audited financial information prior to submission to REAC. Finally, the Appendices contain sample reporting language, information on HUD programs and compliance issues contained in the HUD audit guide

## 1.3 Scope

This document provides guidance to owners, management agents, accountants and CPAs who participate in, or audit, the following FHA/HUD programs<sup>4</sup>:

- ~~☞~~ Insured, co-insured and HUD-held mortgages;
- ~~☞~~ Direct loans;
- ~~☞~~ Capital Advances;
- ~~☞~~ Project-based Section 8 rental subsidies, when the Housing Assistance Payment (HAP) contract requires the submission of annual financial statement information to HUD; and
- ~~☞~~ Mortgage Interest Subsidy programs with Use Agreements and other Use Agreements that require submission of annual audited financial statements.

For further information on Project-based Section 8 see Handbook 4350.3.

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<sup>3</sup> Currently, the Financial Accounting Standards Board (FASB), the Government Accounting Standards Board (GASB), the American Institute of Certified Public Accountants (AICPA) and the General Accounting Office (GAO) promulgate these standards.

<sup>4</sup> Refer to Appendix 1 for a listing of covered programs.

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This guide is effective upon publication. This guide does not modify or replace any of the existing laws, regulations, contracts or agreements associated with the programs listed above. Owners, management agents, accountants and their auditors should refer to the relevant source documents discussed in this guide to determine each participant's particular program requirements.

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## Accounting Requirements

### 2.1 Background

As a condition of participation in the various FHA/HUD multifamily programs, property owners execute a series of legal agreements with HUD. These agreements contain provisions that allow HUD to exercise control over certain aspects of a participant's operations.

Prior to 1961, FHA exercised control mainly through the receipt of preferred stock issued under the terms stipulated in a corporate charter. Since 1961, FHA/HUD primarily exercises control through a contract called the Regulatory Agreement. The Regulatory Agreement includes the terms and conditions that an owner is contractually obligated to follow while HUD has a financial interest in their property. Typically, HUD's financial interest takes the form of one or more of the following:

- ~~///~~ Mortgage insurance
- ~~///~~ HUD-held mortgage
- ~~///~~ Direct loan
- ~~///~~ Capital grant
- ~~///~~ Interest subsidy
- ~~///~~ Rent subsidy

In order to protect FHA/HUD's financial interest, an owner may enter into one or more of the following:

- ~~///~~ Housing Assistance Payment Contracts
- ~~///~~ Project Rental Assistance Contracts
- ~~///~~ Use Agreements
- ~~///~~ Workout Agreements
- ~~///~~ Loan Agreements
- ~~///~~ Grant Agreements
- ~~///~~ Transfer of Physical Assets (TPA) Agreements
- ~~///~~ "Market-to-Market" Restructuring Agreements

Thus, while HUD has a financial interest in the property, it is important for an owner to understand and adhere to the provisions of their legal agreements with FHA/HUD. Typically, several provisions involve accounting requirements.

### 2.2 Maintain Books and Records in Accordance with HUD Requirements

One of the provisions normally found in the Regulatory Agreement requires an owner to keep the books and accounts of the operations of the mortgaged property

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and of the project<sup>5</sup> according to HUD’s requirements. Those requirements are primarily contained in HUD Handbook 4370.2 Rev-1– *Financial Operations and Accounting Procedures for Insured Multifamily Projects*

### **2.3 HUD Requires the Application of GAAP**

HUD requires owners to use Generally Accepted Accounting Principles (GAAP) to report the results of their operations<sup>6</sup>. 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:*” ([Chapter 3](#) of this guide defines those requirements in detail). For the purpose of this guide, REAC uses the AICPA’s SAS No. 69 hierarchy of “Generally Accepted Accounting Principles”<sup>7</sup>.

### **2.4 Maintain Records in Reasonable Condition for Audit**

Another contract provision contained in a standard Regulatory Agreement requires owners to maintain their books, contracts, records, documents, and other papers relating thereto in a reasonable condition for proper audit and subject to examination and inspection at any reasonable time by HUD. Owners are required to keep copies of all written contracts or other instruments, which affect the mortgaged property, all or any of which may be subject to inspection and examination by HUD.

### **2.5 REAC Standard Chart of Accounts**

In order to ensure uniform financial reporting among program participants, HUD requires the use of a standard chart of accounts for annual financial reporting purposes. Previously, HUD’s official standard chart of accounts was published in HUD Handbook 4370.2. Concurrent with the issuance of the *Uniform Financial Reporting Standards for HUD Housing Programs; Final Rule*<sup>8</sup>, REAC assumed responsibility for developing, maintaining, and publishing the standard chart of accounts for multifamily program participants.

Periodically, REAC makes revisions to the standard chart of accounts to accommodate new financial reporting requirements. When changes are made, REAC publishes those revisions on its Website

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<sup>5</sup> The Regulatory Agreement typically defines the word “Project” to include the mortgaged property and all its assets of whatsoever nature or wheresoever situate, used in or owned by the business conducted on said mortgage property, which business is providing housing and other such activities as are incidental thereto.

<sup>6</sup> Previously this requirement was found at ¶ 2-2 in HUD Handbook 4370.2 REV-1.

<sup>7</sup> Refer to *AICPA Professional Standards, Volume 1, U.S. Auditing Standards*, AU §411.

<sup>8</sup> Published in the *Federal Register, Vol. 63, No. 169, Tuesday, September 1, 1998*

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([http://www.hud.gov/offices/reac/library/lib\\_famf.cfm](http://www.hud.gov/offices/reac/library/lib_famf.cfm)). The standard chart of accounts for multifamily programs is published on REAC's Web site in a document titled [\*Multifamily Financial Reporting Revisions Financial Assessment Subsystem-Multifamily Housing Programs\*](#). Program participants are advised to monitor REAC's web site for future changes to the standard chart of accounts. Data definitions and business rules for the accounts used in the FASS templates are contained in the [Industry User's Guide](#).

It is important to note that, although it is highly recommended, REAC recognizes that it may not be realistic for certain owners (or their management agents) to set up their accounting system to accommodate HUD's prescribed account name and numbering scheme. Thus, REAC's requirement is only that owners must be able to convert the financial information from their systems into REAC's prescribed format for annual financial reporting purposes (refer to [Chapter 3](#) of this guide for further details)<sup>9</sup>.

## **2.6 Tenant Security Deposit Account**

A typical clause found in the Regulatory Agreement requires owners to maintain a separate trust account in the name of the project for any tenant security deposits collected. The balance in this account must at all times equal or exceed the balance in the tenant security deposit liability account.

## **2.7 Replacement Reserve Account**

Another clause normally found in the Regulatory Agreement requires owners to maintain a separate replacement reserve account. This reserve is used to accumulate funds to pay for the replacement of capital items. Typically, each month owners are required to deposit a predetermined amount with the mortgagee or in a safe and responsible federally insured depository designated by the mortgagee. However, some Regulatory Agreements<sup>10</sup> require owners to deposit replacement reserve funds into a separate federally insured bank account.

## **2.8 Residual Receipts Account**

A contract clause found in certain Regulatory Agreements<sup>11</sup> requires non-profit owners to establish and maintain a residual receipts account. These contracts typically require owners to deposit surplus cash (residual receipts) into this account within 90 days after the end of the semiannual or annual fiscal period within which they were received. "Surplus Cash" and "Residual Receipts" are contractual concepts, which are defined in the Regulatory Agreements that use those terms. Generally, surplus cash is the cash remaining after all expenses of

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<sup>9</sup> However, an adequate audit trail should exist to document the conversion from the owner's chart of accounts to the REAC prescribed reporting format.

<sup>10</sup> Normally, those associated with the Section 202 Direct Loan and 202/811 Capital Advance programs.

<sup>11</sup> Normally, those associated with the limited distribution and non-profit programs outlined in Appendix 1.

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the project are paid for or funds are set aside for their payment in the current reporting period. Normally, non-profit owners are required to deposit all surplus cash into their residual receipts account. Limited distribution owners are required to deposit any surplus cash remaining after subtracting their allowable distributions. Owners should refer to the FASS [Industry Users Guide](#) (found at <http://www.hud.gov/offices/reac/products/prodmf.cfm>) and their applicable Regulatory Agreement for a detailed explanation of these concepts and calculations.

## 2.9 Excess Rental Collections

Owners of properties with mortgages insured under Section 236 of the National Housing Act are subject to a unique accounting requirement. This requirement is a product of the program's interest subsidy feature<sup>12</sup>. Under this program, each dwelling unit type has a two-tier rental structure – one based on the “basic rent<sup>13</sup>” – and the other based on an artificial “market rent<sup>14</sup>”. Tenants in Section 236 properties pay rent based on a percentage of their adjusted annual income (as defined by HUD). As a result, some tenants pay rent in excess of the “basic rent” established for their type of dwelling unit<sup>15</sup>. Since an owner's allowable return on investment is based on the Federally subsidized “basic rent”, historically, owners were required to account for and remit to HUD – on a monthly basis – the amount of rent collected in excess of the established “basic rent” benchmark (e.g. “Excess Income”}.

HUD's fiscal year 1997 Appropriations Act (P.L. 104-204) included language that modified the Section 236 Excess Income requirement. Under the provisions of that Act, subject to the terms and conditions established by HUD, owners with certain types of mortgages insured under Section 236 were permitted to retain some or all of their Excess Income. HUD's 1998 and 1999 Appropriations Acts (P.L. 106-74 and P.L. 105-276) expanded the number of Section 236 mortgage types covered by the revised Excess Income provision. HUD's Office of Housing Notices 98-10, 99-28, 00-17, 01-7, and 02-9 (as applicable) enumerate the terms and conditions owners must follow to be eligible to retain Section 236 Excess Income.

Section 236 participants should use form [HUD-93104](#), *Monthly Report of Excess Income* to calculate and report the amount of “excess” rent collected (a copy of this form is located at [http://www.hudclips.org/sub\\_nonhud/html/forms.htm](http://www.hudclips.org/sub_nonhud/html/forms.htm)). All Excess Income that owners are not authorized to keep is the property of the

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<sup>12</sup> Under the Section 236 program, owners receive an interest subsidy allowance from HUD, which reduces the effective interest rate on the outstanding promissory note to 1% over the life of the loan.

<sup>13</sup> Basic rent is determined based on the amount of rent sufficient to pay operating expenses, fund escrows, provide a return to the owner, and service the debt at a 1% interest rate.

<sup>14</sup> Under the 236 program, market rent is merely the basic rent described in footnote 12 plus the unit's pro-rata share of the monthly interest reduction payment.

<sup>15</sup> However, the amount of rent a tenant pays cannot exceed the “market rent” established for their unit.

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Federal Government. Owners should remit excess rental income that they are not authorized to keep to:

Excess Rental Income  
P.O. Box 360333M  
Pittsburgh, PA 15250

Owners of properties participating in the Section 221 (d) (3) BMIR program collect excess rents when the amount charged for a unit exceeds the HUD approved contract rent. Owners of these properties are required to deposit any excess rent collected into their residual receipts account within 90 days after fiscal year end.

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## Financial Reporting Requirements

### 3.1 Background

Although FHA/HUD administers a wide-variety of multifamily housing programs (see [Appendix 1](#)), participating owners fall into three general categories: profit motivated, limited distribution, and non-profit. The terms and conditions contained in an owner's Regulatory Agreement will vary, depending on the type of multifamily program and ownership entity covered. Accordingly, an owner's financial reporting requirements will also vary, based on these factors.

### 3.2 Annual Audited Financial Report

A typical Regulatory Agreement contains the following provision, “*Within sixty (60) days following the end of each fiscal year the Secretary shall be furnished with a complete annual financial report based upon an examination of the books and records of the mortgagor prepared in accordance with the requirements of the Secretary, prepared and certified to by an officer or responsible Owner and, when required by the Secretary, prepared and certified by a Certified Public Accountant, or other person acceptable to the Secretary*”. As a result – historically – owners were contractually obligated to furnish HUD with a copy of their audited annual financial report within 60 days after their fiscal year-end.

However, concurrent with the issuance of the *Uniform Financial Reporting Standards for HUD Housing Programs; Final Rule*, REAC assumed responsibility for collecting and assessing financial statements on multifamily projects. Under REAC, the annual audit filing deadlines were revised to accommodate the electronic filing of financial information to HUD. As a result, the annual filing deadline for owners of profit motivated and limited distribution properties has been permanently extended to 90 days. REAC's electronic filing requirements are discussed in detail at [Sections 3.3](#) and [3.4](#) of this guide.

### 3.3 Electronic Submission of Financial Information

Effective for entities with fiscal years ending on or after December 31, 1998, 24 CFR Part 5, Subpart H requires covered owners<sup>17</sup> to submit annual financial information, “...*electronically to HUD through the internet, or in such other electronic format designated by HUD, or in such non-electronic format as HUD may allow if the burden or cost of electronic reporting is determined to be excessive...*” Accordingly, the electronic submission filing requirements for

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<sup>16</sup> Refer to the Single Audit Act of 1984, P.L. 98-502, and the Single Audit Act Amendments of 1996, P.L. 104-156.

<sup>17</sup> Refer to Appendix 1 and [24 CFR Part 5, Subpart H](#) for a complete listing of covered entities.

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multifamily program participants are summarized below. For submissions that are other than Owner Certified, the financial information will be based on the entity's annual audited financial statements.

**Profit Motivated and Limited Distribution Owners:**

Profit motivated and limited distribution owners shall:

- ✍ Submit within 90 days after the ownership entity's fiscal year end<sup>18</sup> an electronic version of information from the ownership entity's annual audited financial report in REAC's prescribed format (refer to [Section 3.4](#)).
- ✍ Submit the information required in [Section 3.4](#) through the Internet using the FASS.

**Non-Profit Owners**

The submission requirements for non-profit owners are more complicated. The type of submission(s) a non-profit owner will file with REAC is based on the total amount of Federal awards expended by the entity during the reporting year (as defined by [OMB Circular A-133](#)<sup>19</sup>). Non-profit owners should carefully review OMB's basis for determining Federal awards expended. Under OMB's definition, total Federal awards includes not only expenditures associated with Federal awards from all agencies (not just HUD), but also other items such as the amount of outstanding Federal loan guarantees and capital grants. REAC's electronic submission filing requirements for non-profit owners are:

- ✍ If the ownership entity expends less than \$300,000 in Federal awards during the reporting year, the owner shall:
  - ✍ Submit within 90 days after the ownership entity's fiscal year end an electronic version of the project's *Owner Certified* annual financial report<sup>20</sup> in REAC's prescribed format (refer to [Section 3.4](#)).
  - ✍ Submit the information required in [Section 3.4](#) through the Internet using the FASS.
- ✍ If the ownership entity expends \$300,000 or more in Federal awards during the reporting year, the owner shall:
  - ✍ Submit within 90 days after their fiscal year end, an electronic version of the project's *Owner Certified* annual financial report in REAC's prescribed format (refer to [Section 3.4](#)).

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<sup>18</sup> On March 27, 2000 HUD published in the Federal Register a final rule, which permanently extends the filing deadline to 90 days (refer to the [Federal Register, Vol. 65, No.59, 24 CFR Parts 5 and 266, March 27, 2000](#)).

<sup>19</sup> [OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, § .205](#).

<sup>20</sup> REAC refers to this type of FASS submission as "owner-certified".

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- ✍️ Submit within the earlier of 30 days after receipt of the auditors' report(s), or nine months after the end of the audit period, an electronic version of information from the project's *audited* financial report in REAC's prescribed format (refer to [Section 3.4](#)).
  - ✍️ The *Owner Certified* submission requirement is waived for owners who file their submission from the project's audited financial report within 90 days after their fiscal year end.
  - ✍️ Submit the information required in [Section 3.4](#) through the Internet using the FASS.

For additional information on the REAC electronic submission process, owners should refer to the [Industry Users Guide](#) located on REAC's web site at [http://www.hud.gov/reac/products/fass/fassmf\\_guide.html](http://www.hud.gov/reac/products/fass/fassmf_guide.html).

### 3.4 Required Financial Information (Annual Financial Report Submission)

Effective for entities with fiscal years ending on or after December 31, 1998, 24 CFR Part 5, Subpart H requires covered owners to, "...provide to HUD on an annual basis, such financial information as required by HUD..." The [Industry Users Guide](#) referred to in Section 3.3 above contains a detailed discussion of the annual financial information HUD requires owners to submit electronically to REAC via the Internet. That information generally includes:

- ✍️ **Statement of Financial Position (Balance Sheet)** – a financial statement presented in REAC's prescribed format, which includes more detail than a GAAP basis Balance Sheet,
- ✍️ **Statement of Profit and Loss (or Statement of Activities if a non-profit)** – a financial statement presented in REAC's prescribed format which includes more detail than a GAAP basis Statement of Profit and Loss. It resembles form HUD – 92410, the form previously used by multifamily program participants to report income and expense items. This statement requires owners to disclose "Gross Potential Income" less vacancies to arrive at Net Rental Income. It also has a "Part II" section, which is used to report required supplemental information.
- ✍️ **Statement of Changes in Partners' Equity (or Statement of Changes in Net Assets/Changes in Members' Equity if a non-profit)** – a financial statement presented in REAC's prescribed format which includes more detail than a GAAP basis Statement of Changes in Partners' Equity. This statement's title and presentation will vary, depending on the type of ownership entity reporting.
- ✍️ **Statement of Cash Flows** – a financial statement presented in REAC's prescribed format, which includes more detail than a GAAP basis Statement of Cash Flows prepared using the direct method,.

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☞ **Footnotes to the basic financial statements including descriptions of accounting policies** – owners should submit the footnotes from their annual audited (or Owner Certified when applicable) financial statements, in REAC’s prescribed format.

☞ **Supplemental Computation of Surplus Cash, Distributions and Residual Receipts** – a schedule used to document an owner’s computation of surplus cash. It resembles form HUD – 93486, the form previously used by multifamily program participants to perform this computation.

☞ **Supplemental Schedule of Reserve for Replacements** – a schedule that analyzes Replacement Reserve account activity for the reporting period.

☞ **Supplemental Schedule of Residual Receipts** – (if applicable) a schedule that analyzes Residual Receipts account activity for the reporting period.

☞ **Supplemental Schedule of Changes in Fixed Assets** – used to provide information on additions and disposals of fixed assets.

☞ **Supplemental Schedule of 5300 Accounts** – (if applicable) used to provide account detail related to Nursing Home Elderly and Congregate Service Income items.

☞ **Supplemental Schedule of 6900 Accounts** – (if applicable) used to provide account detail related to Nursing Home Elderly and Congregate Service Expense items.

☞ **Supplemental Nursing Home Data** – (if applicable) used to provide information on the number of licensed beds, capacity/patient day/utilization, and census.

☞ **Supplemental Account Detail** - (if applicable) used to provide additional detail on miscellaneous account items. Supplemental account detail should be provided when required on REAC’s prescribed template.

☞ **Corrective Action Plan** – (if applicable), prepared by management in REAC’s prescribed format. **O**

☞ **Owners’ Certification** – include the following certification language:

*"I/we hereby certify that I/we have examined the accompanying financial statements and supplemental data of (mortgagor's name) and, to the best of my/our knowledge and belief, the same is complete and accurate."*

Include the name(s) of the individual certifying to the accuracy of the financial information based on the following criteria:

☞☞ Certification by the mortgagor, when an individual owns the property.

☞☞ Certification by two or more partners (including at least two general partners if there are two or more general partners), when a limited partnership owns the property.

☞☞ Certification by two officers, one of which must be the president of the corporation, when a corporation owns it.

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- ☞ Certification by one member, when a limited liability company or a limited liability partnership owns the property.
  - ☞ Certification by all joint ventures or partners, when a general partnership owns the property.
  - ☞ Certification by the trustee and appropriate beneficiaries when the property is owned by a trust.

☞ **Management Agent's Certification** – when a management agent is used to manage the reporting property, a certification is required identifying the individual, as well as the company responsible for management.

Include the following certification language:

*"I/we hereby certify that I/we have examined the accompanying financial statements and supplemental data of (mortgagor's name) and, to the best of my/our knowledge and belief, the same is complete and accurate."*

It is important for owners to note that the management of a company is responsible for maintaining adequate accounting records and preparing proper full disclosure financial statements (see [Section 4.3](#) for Annual Financial Report requirements). As further discussed in Chapter 4, the independent auditors' role in the audit process is to provide reasonable assurance to the users of the financial statements that the statements are fairly presented in all material respects. In essence, the auditors' product is their report(s). In that regard, for audited submissions, owners are required to submit electronically to REAC information about the results of the reporting entity's audited Annual Financial Report including<sup>21</sup>:

- ☞ Type of opinion received on the *Independent Auditors' Report* on entity's basic financial statements.
- ☞ An indication of whether there was going concern explanatory paragraph included in the *Independent Auditors' Report*.
- ☞ The *Independent Auditors' Report on HUD required Supplemental Data*.
- ☞ An indication of whether there were "reportable conditions" and/or "material weaknesses" identified in the *Independent Auditors' Report on Internal Control over Financial Reporting*.
- ☞ An indication of whether there were "reportable conditions" and/or "material weaknesses" identified in *The Internal Control Report related to the Financial Statements and Major Programs* (if applicable).
- ☞ Type of opinion received on the *Independent Auditors' Report on Compliance with Specific Requirements Applicable to Major HUD Programs* (if applicable).

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<sup>21</sup> Owners should refer to the *Industry User Guide* for instructions on how to file electronic submissions to REAC. This document is located on HUD's website at [http://www.hud.gov/offices/reac/products/fass/fassmf\\_guide.cfm](http://www.hud.gov/offices/reac/products/fass/fassmf_guide.cfm)

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- ~~✎~~ *The Report on Compliance Applicable to each major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133. (if applicable)*
  - ~~✎~~ *An indication of whether any instances of “material non-compliance” were identified in the *Independent Auditors’ Report on Compliance with Specific Requirements Applicable to Major HUD Programs (if applicable)*.*
  - ~~✎~~ *An indication of whether any instances of “material non-compliance” were identified in the *Independent Auditors’ Report on Compliance with Specific Requirements Applicable to Non-Major HUD Programs (if applicable)*.*
  - ~~✎~~ *An indication of whether any instances of “material non-compliance” were identified in the *Independent Auditors’ Report on Compliance with Specific Requirements Applicable to Affirmative Fair Housing and Non-Discrimination*.*
  - ~~✎~~ *Independent Auditors’ Schedule of Findings and Questioned Costs (if applicable) in REAC’s prescribed format.*

### **3.5 Other Reporting Requirements**

Owners are advised that this chapter covers the annual financial reporting requirements discussed at 24 CFR Part 5, Subpart H and [Section 3.2](#) of this guide. Normally, Regulatory Agreements, HAP contracts, as well as other legal arrangements (refer to [Section 2.1](#)) contain provisions, which require owners to provide, separate from the annual financial report, financial information to the Secretary, his agents, employees or attorneys. Owners and their advisors should carefully review and adhere to those reporting requirements.

### **3.6 Annual Audited Financial Report Retention**

Owners of profit motivated and limited distribution properties are required to retain a “hard copy” of their annual audited financial report (as described in [Section 4.3](#) of this document) for a period of three years. Non-profit owners should also submit a “hard copy” of their “reporting package” to the Federal Clearinghouse as designated by OMB in accordance with [§ .320 of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations](#). When requested, owners shall make available a “hard copy” of these reports to the Secretary, his agents, employees or attorneys, including employees from the REAC, HUD’s Inspector General, and HUD’s Enforcement Center.

### **3.7 Consolidated Reports**

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There are several instances within HUD's multifamily portfolio where multiple projects were developed under a single owning entity, i.e. two or more projects sharing the same tax identification number (TIN). If the TIN is not identical an owner may not file a consolidated statement as described below.

**FASS was modified to allow owners of any type to submit consolidated financial statements, where more than one property is owned under a single TIN. Further information on this FASS feature is contained in *Submission and Review Requirements and REMS Data Dependencies for Annual Financial Statements*, which is available at**

**[http://www.hud.gov/utilities/intercept.cfm?http://www.hud.gov/offices/reac/pdf/financial memo to field rev 10.pdf](http://www.hud.gov/utilities/intercept.cfm?http://www.hud.gov/offices/reac/pdf/financial%20memo%20to%20field%20rev%2010.pdf)**

### **3.8 Auditor Independence**

The U.S. General Accounting Office has issued Amendment No.3 *Independence* to the Government Auditing Standards (1994 Revision), which substantially changes the previous standard to better serve the public interest and to maintain a high degree of integrity, objectivity and independence for audits of entities subject to the Government Auditing Standards. While the new amendment deals with a range of auditor independence issues, the most significant change relates to the rules associated with nonaudit or consulting services. Auditors should refer to Amendment No.3 and the accompanying Question and Answer document for further information related to audits described in this document, related audit products and nonaudit services to HUD assisted projects.

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## Annual Audit Guidance

### 4.1 Background

This chapter contains HUD's requirements for conducting annual financial audits of entities participating in the profit motivated and limited distribution multifamily housing programs listed in [Appendix 1](#).

Separately, practitioners with non-profit clients who participate in FHA/HUD programs covered by the Single Audit Act should conduct financial audits in accordance with [OMB Circular A-133](#) and the associated compliance supplement.

### 4.2 General Audit Requirements

Audits of program participants covered by this chapter must:

- ✍ Be performed in accordance with Generally Accepted Auditing Standards (GAAS)<sup>22</sup> and Generally Accepted Government Auditing Standards (GAGAS)<sup>23</sup>. A copy of the "Yellow Book" is published on the General Accounting Office's (GAO) web site at <http://www.gao.gov/>.
- ✍ Be performed by a licensed Certified Public Accountant (CPA) or a licensed Certified Public Accounting firm in accordance with the laws of the state where the audit is performed.
- ✍ Cover the Annual Financial Report items discussed in [Section 4.3](#) of this guide.
- ✍ Cover the participating ownership entity unless otherwise stipulated by HUD.

### 4.3 Annual Financial Report

As discussed in [Chapter 3](#) of this guide, contract provisions and HUD regulations require program participants to submit to REAC an electronic version of the ownership entity's audited Annual Financial Report in REAC's prescribed format. [Section 3.4](#) of Chapter 3 details REAC's prescribed *electronic* reporting format. This chapter describes the Independent Auditors' responsibilities when conducting an audit of a covered program participant. Nevertheless, it is important to note that it is the owner's responsibility - not the auditors' - to file an accurate electronic submission with HUD's REAC. The auditors' role is to

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<sup>22</sup> The American Institute of Certified Public Accountants promulgate these standards. Refer to *AICPA Professional Standards, Volume I, U.S. Auditing Standards*.

<sup>23</sup> As published by the [General Accounting Office](#) in a document titled, *Government Auditing Standards*. This document is also known as the "Yellow Book".

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conduct and report the results of their audit in accordance with GAAS and GAGAS. In that regard, the Independent Auditor shall:

✍ Issue an ***Independent Auditors' Report*** (refer to [Example A](#)) on the ownership entity's basic financial statements. This report should cover the following items:

✍✍ Balance Sheet

✍✍ Statement of Income

✍✍ Statement of Changes in Partner's Capital<sup>24</sup>

✍✍ Statement of Cash Flows

✍✍ Footnotes to the basic financial statements, including descriptions of accounting policies.

✍ Issue an ***Independent Auditors' Report*** (refer to [Example A](#)) on the accompanying supplemental information required by HUD's REAC. This report may be added to the auditors' report on the basic financial statements or may appear separately in the auditor-submitted document<sup>25</sup>. This report shall cover the following supplemental information items previously described in [Section 3.4](#) of this document:

✍✍ Statement of Financial Position (Balance Sheet) – in HUD's prescribed format

✍✍ Statement of Profit and Loss – in HUD's prescribed format

✍✍ Statement of Changes in Partners' Equity – in HUD's prescribed format

✍✍ Statement of Cash Flows – in HUD's prescribed format

✍✍ Supplemental Computation of Surplus Cash, Distributions and Residual Receipts

✍✍ Supplemental Mid-Year Computation of Surplus Cash, Distributions and Residual Receipts (if applicable)

✍✍ An indication of whether there were "reportable conditions" and/or "material weaknesses" identified in the

✍✍ Supplemental Schedule of Reserve for Replacements

✍✍ Supplemental Schedule of Residual Receipts (if applicable)

✍✍ Supplemental Schedule of Changes in Fixed Assets

✍✍ Supplemental Schedule of 5300 Accounts (if applicable)

✍✍ Supplemental Schedule of 6900 Accounts (if applicable)

✍✍ Supplemental Nursing Home Data if applicable)

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<sup>24</sup> Or similarly titled report based on the type of participating ownership entity. For example, if a Limited Liability Company owns the property, a *Statement of Changes in Members' Equity* should be opined upon.

<sup>25</sup> Refer to [AICPA Professional Standards, Volume 1, U.S. Auditing Standards](#), AU §551.06 e.

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✍️✍️ Supplemental Account Detail (if applicable)

✍️✍️ Issue an *Independent Auditors' Report on Internal Control* (refer to [Example B](#)). Independent Auditors should report deficiencies in internal control that they consider “reportable conditions” and/or “material weaknesses” as defined in AICPA and GAO standards.

✍️✍️ Issue an *Independent Auditors' Report on Compliance with Specific Requirements Applicable to Major HUD Programs* (if applicable – refer to [Example C](#)). See [Section 4.4](#) of this chapter for a discussion on compliance testing.

✍️✍️ Issue an *Independent Auditors' Report on Compliance with Specific Requirements Applicable to Non-Major HUD Programs* (if applicable – refer to [Example D](#)).

✍️✍️ Issue an *Independent Auditors' Report on Compliance with Specific Requirements Applicable to Affirmative Fair Housing and Non-Discrimination* (refer to [Example E](#)).

✍️✍️ Issue an *Independent Auditors' Schedule of Findings and Questioned Costs* (refer to [Example F](#)).

✍️✍️ Issue an *Independent Auditors' Comments on Audit Resolution Matters Relating to the HUD Programs* (refer to [Example G](#))

## 4.4 Compliance Testing and Internal Control Work

### *Audit Scope and Approach*

The scope of the Independent Auditor’s testing of internal controls over financial reporting is limited to obtaining a sufficient understanding of internal controls to plan the audit and determine the nature, timing, and extent of tests to be performed. Typically, those procedures would be less in scope than would be necessary to render an opinion on the client’s internal control policy and procedures. Accordingly, for the purpose of this guide, Independent Auditors’ are not required to express such an opinion. However, Independent Auditors are required to report all instances of “reportable conditions” and/or “material weaknesses” identified by the procedures they do perform. The auditor should issue the report on internal control in accordance with the *Government Auditing Standards*.

The scope of the Independent Auditors’ testing of compliance with laws and regulations is limited to the client’s compliance with the applicable HUD laws and regulations regardless of the amount of Federal financial assistance the client receives. The auditors’ report on compliance should include an opinion on the client’s compliance with specific requirements applicable to each of its major programs.

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The term major program means an individual assistance program or a group of programs in a category of Federal financial assistance, which exceeds \$300,000 during the applicable year. For example if an ownership entity has an outstanding HUD-insured or guaranteed loan balance exceeding \$300,000 as of the reporting date, that program would be considered a major program.<sup>26</sup>

For ownership entities with HUD-assisted program activity of \$300,000 or less for the period under audit (a non-major program), the auditor must also test and report on the entity's compliance with specific HUD program requirements.

The compliance tests discussed in this section should cover the laws, regulations and contract provisions that have a direct and material effect on a HUD multifamily major program. Ordinarily, these compliance tests also will cover all significant laws and regulations pertaining to the multifamily program participant's financial statements. In such cases, the compliance reports discussed at [Section 4.3](#) of this guide are the only reports necessary for reporting on the client's compliance with laws and regulations. However, if the Independent Auditor, as part of the audit of the financial statements, considered laws and regulations in addition to those noted in this guide, for which noncompliance could have a direct and material effect on the financial statements, the auditor should also issue the compliance report in accordance with GAGAS (as illustrated in SOP 98-3).

A client's compliance requirements will vary depending on the type of multifamily program(s) and ownership entity covered. Accordingly, the audit requirements for testing compliance with specific HUD laws and regulations will vary based on those factors. A summary of the material compliance requirements, by program type, is included at [Appendix 2](#). Suggested audit procedures for testing each of those requirements follow.

## **Compliance Requirements and Audit Areas**

***Note: As a matter of convenience to the reader, the following is reproduced in its entirety from Chapter 4 of Handbook 2000.04 REV-2 CHG 1, Consolidated Audit Guide for Audits of HUD Programs.***

### A. Federal Financial Reports

1. **Compliance Requirement.** Projects participating in HUD-assisted activities are required to ensure that financial status reports contain reliable financial data and are presented in accordance with the terms

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<sup>26</sup> When making this determination follow the instructions contained [in OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, § .205.](#)

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of applicable agreements between the entity and HUD. The individual agreements contain the specific reporting requirements that the entity is to follow.

2. Suggested Audit Procedures

- a. Identify all required financial reports by inquiry of the owner/manager.
- b. Obtain an understanding of the auditee's procedures for preparing and reviewing the financial reports.
- c. Select a sample of financial reports, other than those which are included in the audited financial statements, and determine that the reports selected are prepared in accordance with HUD instructions.
- d. For the sample, trace significant data to supporting documentation, i.e. worksheets, ledgers, etc. Report all material differences between financial reports and project records.
- e. Review significant adjustments made to the general ledger accounts affecting HUD-assisted activity and evaluate for propriety.
- f. For a Section 236 Interest Reduction Payment Subsidy project, obtain a sample of the Monthly Reports of Excess Income for the period under audit and test the accuracy. Reconcile any differences. Report any delinquent unremitted excess income of the project as of the end of the period under audit as a finding. Determine if the owner has approval to retain excess income. If the owner is under a repayment plan for delinquent excess income, determine compliance with the plan.

B. Fair Housing and Non-Discrimination

1. Compliance Requirement. Management and owners of all insured projects are prohibited from discriminatory practices in accepting applications, renting units and designating units or sections of a project for renting to prohibited bases of the "Fair Housing Act" and according to the Regulatory Agreement.
2. Suggested Audit Procedures
  - a. Obtain a copy of the owner's approved Affirmative Fair Housing Marketing Plan, if applicable to the project.

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- b. Inquire of the owner/manager as to policies and procedures relating to: marketing of the units; processing, approving and rejecting applications, including determining that applicants are processed and selected in appropriate order; and providing reasonable accommodation to applicants and tenants with disabilities in accordance with the requirements of applicable federal civil rights laws
  - c. Test whether procedures were placed in operation as established by management through inquiry and examination of documentary evidence.
  - d. Review a sample of correspondence files for applications rejected, including documented reasons for valid rejections, or tenants evicted and legal invoices for any evidence of litigation or potential litigation related to discriminatory rental practices.
  - e. Determine that the HUD-approved Equal Housing Opportunity logo, slogan or statement is displayed in marketing materials.

C. Mortgage Status

1. Compliance Requirement. Owners shall promptly make all payments due under the note and mortgage (Regulatory Agreement).
2. Suggested Audit Procedures
  - a. Read the promissory mortgage note, mortgage (or deed of trust), and associated loan amortization schedule to determine the terms and conditions of those agreements. Obtain an understanding of the owner's procedures for assuring prompt payment of the mortgage
  - b. Obtain or prepare a schedule of the client's mortgage and escrow payments and withdrawals for the reporting period. The schedule should include the amount, by escrow item, and date each item was paid or disbursed.
  - c. Verify that the monthly mortgage and escrow payments were made.
  - d. Confirm the outstanding loan balance and annual escrow account activity with the loan servicer as of the client's fiscal year end. Determine if payment on the notes are current at the

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reporting entity's fiscal year end. (Note: the auditor should use alternative procedures to satisfy this requirement if the auditor considers the confirmation process unreliable or impractical.)

- e. If the project is operating under an agreement, (mortgage modification agreement, workout agreement, forbearance agreement, use agreement, etc.) test whether the owner is complying with the terms and conditions.

D. Replacement Reserve

1. Compliance Requirement. Owners of profit motivated and limited distribution properties shall establish a reserve for replacement account and make deposits in accordance with HUD requirements. Disbursements from such fund may be made only after receiving written consent from HUD. (Source – HUD Regulatory Agreement)
2. Suggested Audit Procedures
  - a. Obtain an understanding of the project owner's procedures, including the Regulatory Agreement (and any amendments or other written agreements with HUD) for establishment and maintenance of the fund and for making approved disbursements from the reserve fund.
  - b. Determine that the reserve fund has been established in a federally insured depository approved by the mortgagee, interest was retained in the account and test whether the conditions were met for the funds not federally insured for the period.
  - c. Using the schedule prepared for the mortgage status compliance requirement, verify the reserve for replacement account activity for the reporting period for compliance with the client's Regulatory Agreement.
  - d. Verify that deposits were made into the replacement reserve.
  - e. Trace disbursements from the reserve for replacement to the associated HUD approval form and canceled invoices. Trace to the client's general ledger, monthly (or annual) mortgage statement(s) and the schedule prepared above. Determine if sampled disbursements were authorized by HUD and used for the purpose authorized by HUD.

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- f. Confirm the account balance and annual reserve for replacement account activity with the loan servicer as of the client's fiscal year end. (Note: the auditor should use alternative procedures to satisfy this requirement if the auditor considers the confirmation process unreliable or impractical.)

E. Residual Receipts

1. Compliance Requirement. Owners of limited distribution properties shall establish a residual receipts account and make deposits into the account in accordance with HUD requirements. Disbursements from such fund may be made only after receiving written consent from HUD (source – HUD Regulatory Agreement).
2. Suggested Audit Procedures
  - a. Read the client's Regulatory Agreement (and any amendments) to determine the client's requirements for making deposits into the residual receipts fund. Normally, program participants are required to deposit "surplus cash" into the account within 60 days after the end of each fiscal year.
  - b. Determine that the prior year's amount required to be deposited to the residual receipts fund was calculated correctly and deposited within 60 days of the close of the fiscal year.
  - c. Using the schedule prepared for the mortgage status compliance requirement, test verify the residual receipts account activity for the reporting period for compliance with the client's Regulatory Agreement.
  - d. Verify that deposits were made into the residual receipts account.
  - e. Trace disbursements from the residual receipts account to the associated HUD approval form and canceled invoices. Trace to the client's general ledger, monthly (or annual) mortgage statement(s) and the schedule prepared above. Determine if sampled disbursements were authorized by HUD and used for the purpose intended.
  - g. Confirm the account balance and annual residual receipts account activity with the loan servicer as of the client's fiscal year end. (Note: the auditor should use alternative procedures to satisfy this

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requirement if the auditor considers the confirmation process unreliable or impractical.

h. Test whether established procedures for deposit of cash receipts into a federally insured bank are being followed through inquiry and examination of documentary evidence.

F. Distributions to Owners

1. Compliance Requirement. Owners of profit motivated and limited distribution properties are not allowed to make, or receive and retain any distribution of assets or any income of any kind of the project except surplus cash. Surplus cash distributions can only be made as of and after the end of a semiannual or annual fiscal period. Surplus cash distribution cannot be made when the owner is in default under any of the terms of the Regulatory Agreement or under the note or mortgage. The allowable distribution for limited distribution owners is further restricted to a percentage of the owner's initial equity investment as described in the Regulatory Agreement or subsequent HUD approved agreements.<sup>27</sup>

2. Suggested Audit Procedures

- a. Read the client's Regulatory Agreement (and any amendments or associated documents) to determine the client's requirements for receiving distributions.
- b. Inquire of management about the existence of any notices of default under any of the terms of the Regulatory Agreement and read any notices.
- c. Inquire of management about the payment of distributions during the reporting period. Conduct follow-up or corroboration of management's responses as considered necessary.
- d. Read the minutes of Board Partner meetings held during the reporting period for evidence of any discussions about distributions.
- e. Scan cash disbursements for evidence of payments made to the project owners. Trace payments and determine if they are allowable under the terms of the Regulatory Agreement.
- f. If applicable, determine that surplus cash computations were prepared in accordance with HUD criteria.

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<sup>27</sup> This amount is usually either 6% or 10% of the owner's original equity investment as determined by HUD

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G. Tenant Application, Eligibility, and Recertification

1. Compliance Requirement. Owners who participate in HUD's rent subsidy programs are responsible for accepting applications, correctly calculating the tenant's contribution toward rent and utilities and correctly calculating any subsidy. They are also responsible for determining initial tenant eligibility, annual recertification of tenant eligibility, and rectifying improper or inaccurate tenant information.
2. Suggested Audit Procedures
  - a. Compare the client's procedures for accepting applications, determining initial eligibility, total tenant payment, and reexamination of eligibility with the provisions in HUD Handbook 4350.3.
  - b. Review a sample of tenant files to determine that applications are complete, signed by the applicant, that tenants met the eligibility requirements pertaining to their subsidized unit for annual income, and family composition, that the tenant payment was calculated correctly and that the family income was reexamined on an annual basis. Include in the sample some of the oldest and some of the most recently admitted tenants.
  - c. Review a sample of tenant files for evidence of whether the owner noted any improper or inaccurate information while determining tenant eligibility or during tenant recertification. If so, determine that the owner followed the guidance in HUD Handbook 4350.3 pertaining to overpayment of a subsidy and follow-up to suspected fraud.
  - d. Review a sample of tenant files to determine that the tenant file contains the following documents as follows:
    - (1) Application
    - (2) Required verifications of social security numbers, disability status, waiting list preferences, income and allowances for adjusted income
    - (3) Lease/Lease addenda in the form as required by HUD
    - (4) Certification and recertification forms (Form HUD-50059)

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- (5) Move-In and Move-Out inspections
  - (6) Computation of tenant's contribution toward rent and utilities and the subsidized portion of the tenant's monthly rent
- e. Test Section 8 rents to ensure that those rents do not exceed the fair market rents.
  - f. Compare the amount claimed per the HAP billing to the supporting documentation in the tenant files.
  - g. Verify the mathematical accuracy of the billing, including the accuracy of the total number of units on the bill.

#### H. Management Functions

1. Compliance Requirement. The owner is responsible for performing management functions or contracting with a management agent to provide project management. The owner or the owner's agent must be approved by HUD to manage a project and must certify that they will adhere to HUD's project management regulations.
2. Suggested Audit Procedures
  - a. Determine that the owner's designated management agent has obtained a fidelity bond in an amount at least equal to two months potential collections. Where an agent has multiple projects, the coverage must be at least equal to two months of the highest potential collections. All principals of the management entity and all persons who participate directly or indirectly in the management and maintenance of the project and its assets, accounts and records must be covered.
  - b. Test work orders and complaints for timely follow up and adherence to management's procedures.
  - c. Test management's procedures for ensuring that units meet applicable housing quality standards.
  - d. Inquire whether management has conducted routine unit and general property inspections, and if findings were identified, whether corrective action was taken (HUD Form 9834 Part A.4).

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- e. Inquire of management about any fees charged to the project for property management services. Also inquire about whether there has been a change in the project's property management agent. Conduct follow-up or corroboration of management's responses as considered necessary.
  - f. Read a copy of the owner's latest HUD approved management certification (form HUD-9839a, b, or c. as appropriate). Determine if HUD has approved the current management agent.
  - g. Review the management certification to determine if the owner has disclosed the existence of an identity of interest (item 12).
  - h. Review the Management Entity Profile for disclosure of identity of interest companies
  - i. Review the maintenance contracts and vendor invoices for identity of interest relationships with the owner/agent and agent/service contractor.
  - j. Test a sample of payments, including those made to identity of interest relationship for services, supplies, etc., to determine that the amounts do not exceed the amounts ordinarily paid for such services and supplies.
  - k. Obtain from client or prepare a schedule analyzing the fees charged to the project for management services. Trace the amounts on the schedule to the client's general ledger.
  - l. Compare the schedule created above to form HUD-9839. Determine if the management fees charged exceeds the HUD approved amount.
  - m. Determine there is hazard insurance comprehensive general liability coverage on industry standard form, in an amount required by the project's mortgage.

I. Unauthorized Change of Ownership/Acquisition of Liabilities

1. Compliance Requirements. Owners of profit motivated and limited distribution properties shall not, without the prior written consent of HUD, convey, transfer, or encumber any of the mortgaged property, or permit the conveyance, transfer of encumbrance of such property (Source – HUD Regulatory Agreement).

2. Suggested Audit Procedures

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- a. Inquire of management about the existence of any agreements to sell or encumber any of the mortgaged property and read any agreements.
  - b. Confirm all material debt agreements listed on the client's balance sheet. Review confirmations to determine if a change of ownership has occurred, or if any of the mortgaged property was encumbered without HUD approval.
  - c. Review the results of the audit procedures applied to specific accounts or other general procedures to identify the existence of any unauthorized conveyance, transfer, or encumbrance of any of the mortgaged property.
  - d. Read the minutes of Board Partner meetings held during the reporting period for evidence of any unauthorized conveyance, transfer, or encumbrance of any of the mortgaged property.

J. Unauthorized Loans of Project Funds

- 1. Compliance Requirements. Owners of profit motivated and limited distribution properties shall not, without the prior written consent of HUD, assign, transfer, dispose of, or encumber any personal property of the project, including rents, or pay out any funds except from surplus cash, except for reasonable operating expenses and necessary repairs (Source – HUD Regulatory Agreement).
- 2. Suggested Audit Procedures
  - a. Inquire of management about the existence of any agreements to assign, transfer, dispose of, or encumber any of the personal property of the project, including rents and read any agreements.
  - b. Review the results of the audit procedures applied to specific accounts or other general procedures to identify the existence of any unauthorized transactions.
  - c. Read the minutes of Board Partner meetings held during the reporting period. Highlight discussions of any unauthorized agreements to assign, transfer, dispose of, or encumber any of the personal property of the project.

K. Unauthorized Transfer of Beneficial Interest

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1. Compliance Requirements. Owners of profit motivated and limited distribution properties shall not, without the prior written consent of HUD, convey, assign, or transfer any beneficial interest in any trust holding title to the property, or the interest of any general partner in a partnership owning the property, or any right to manage or receive the rents and profits from the mortgaged property (Source – HUD Regulatory Agreement).
  2. Suggested Audit Procedures
    - a. Inquire of management about the existence of any agreements to convey, assign, or transfer any beneficial interest.<sup>28</sup>
    - b. Review the results of the audit procedures applied to specific accounts or other general procedures to identify the existence of any unauthorized conveyance, assignment, or transfer of any beneficial interest of any of the owners.
    - c. Read the minutes of Board Partner meetings held during the reporting period for evidence of discussions of any unauthorized conveyance, assignment or transfer of any beneficial interest of any of the owners.

L. Excess Income

1. Compliance Requirements. Owners of limited distribution properties with mortgages insured under Section 236 of the National Housing Act must obtain prior authorization from HUD before retaining Excess Income and use Excess Income only for HUD authorized purposes.
2. Suggested Audit Procedures
  - a. Inquire of management about the existence of a letter of permission or denial from HUD with respect to Excess Income. If the owner has received a letter from HUD permitting or denying the retention of Excess Income, obtain and read a copy of that correspondence from the property's management.
  - b. Select a sample of the HUD forms HUD-93104, *Monthly Report of Excess Income* filed by the client, covering the period under audit. Determine if the reports selected were prepared in accordance with HUD instructions.

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<sup>28</sup> Beneficial interest is generally the right to profits from an estate or property, without owning the estate or property.

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- c . For the sample, determine if the client retained Excess Income or remitted the amount collected to HUD in accordance with HUD instructions. Trace amounts retained back to the client's supporting records.
  - d . If Excess Income was retained by the client, determine if:
    - ?? HUD approved if the amount retained
    - ?? The amount retained was used for authorized purposes as enumerated in the Office of Housing Notices 98-10, 99-28, 00-17 or other Housing Notices issued as applicable Housing Notices.

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## Attestation Requirements

### 5.1 Background

Effective for submissions on February 9, 2001 and thereafter, REAC is requiring, as part of the electronic submission process (see [Section 3.3](#)), that owners engage a licensed Certified Public Accountant (CPA) or a licensed Certified Public Accounting firm to perform the attestation engagement described in [Section 5.2](#).<sup>29</sup> The purpose of this engagement is to have the practitioner compare the owner's electronically submitted data to a hard copy of the owner's audited Annual Financial Report (see [Chapter 4](#)).

### 5.2 Agreed-Upon Procedures Engagement

To aid in the implementation the UFRS Rule, HUD developed a software program – know as FASS – that is used by property owners to report Owner Certified and/or audited financial information (see [Section 3.3](#)) to HUD. This software captures the information required in [Section 3.4](#) and allows users to electronically submit this information directly to HUD via the Internet. Subject to certain conditions, owners, property management agents, and data entry service providers are authorized to prepare these transmissions. However, the responsibility for accurately submitting Owner Certified and/or audited financial data rests with the property's owner. No auditor involvement is necessary for Owner Certified submissions.

For audited submissions, REAC requires owners to engage a licensed CPA or CPA firm to perform the agreed-upon procedures enumerated in REAC's [Guidelines for Public Housing Authorities, Multifamily Owners and Independent Auditors Under the Uniform Financial Reporting Standards Rule](#) located on REAC's web site at <http://www.hud.gov/offices/reac/products/prodpha.cfm>. Practitioners should perform engagements of this nature in accordance with the AICPA's Statement on Standards for Attestation Engagements (SSAE) No. 10, Chapter 2 *Agreed-Upon Procedures Engagements*, as amended.

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<sup>29</sup>This procedure only applies to submissions with fiscal years ending on December 31, 1999 and before December 31, 2000. For submissions ending on or after December 31, 2000, owners are required to engage a licensed CPA or CPA firm to perform the agreed-upon procedure engagement discussed at [Section 5.2](#).

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In general, once an owner (or an agent of the owner) submits audited financial information via FASS to the REAC secure web site, it resides in a staging database. By “submitting” the audited financial information, the owner attests to the accuracy of this data. At this stage the data is frozen and cannot be changed. A licensed practitioner will then access the owner’s data in the REAC staging database via FASS through the use of an ID and password, compare it with hard copy reports, and then report on the comparison. After the information is reported on, it will be returned to the owner, electronically, for final submission to REAC.

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## Appendix 1 – Covered Programs by Ownership Type

### Profit Motivated Owners

- ~~///~~ Section 207 of the National Housing Act (NHA) (12 U.S.C. 1701 et seq.) (Rental Housing Insurance)
- ~~///~~ Section 213 of the NHA (Cooperative Housing Insurance)
- ~~///~~ Section 220 of the NHA (Rehabilitation and Neighborhood Conservation Housing Insurance)
- ~~///~~ Section 221(d) (3) of the NHA (Housing for Moderate Income and Displaced Families) (without the add-on subsidy)
- ~~///~~ Section 221(d) (4) of the NHA (Housing for Moderate Income and Displace Families) (without the add-on subsidy)
- ~~///~~ Section 221(d) (4) of the NHA (with Section 8 – Housing Assistance, subject to certain constraints)
- ~~///~~ Section 223(f) of the NHA (Existing Multifamily Rental Housing)
- ~~///~~ Section 231 of the NHA (Housing for Elderly Persons)
- ~~///~~ Section 232 of the NHA (Mortgage Insurance for Nursing Homes, Intermediate Care Facilities, Board and Care Homes)
- ~~///~~ Section 234(d) of the NHA (Rental) (Mortgage Insurance for Condominiums)
- ~~///~~ Coinsured under Sections 221(d) and 223(f)
- ~~///~~ Section 241 of the NHA (Supplemental Loans for Multifamily Projects), if the only loan on the project
- ~~///~~ Section 542(c) of the Housing and Community Development Act of 1992 (12 U.S.C. 1707 note) (Housing Finance Agency Risk-Sharing Program)
- ~~///~~ 24 CFR Part 880 Section 8 - New Construction
- ~~///~~ Part 881 Section 8 – Substantial Rehabilitation

### Limited Distribution Owners

- ~~///~~ Section 221(d) (3) of the NHA (with rental assistance)
- ~~///~~ Section 221(d) (4) of the NHA (with rental assistance)
- ~~///~~ Section 236 of the NHA (Rental and Cooperative Housing for Lower Income Families)

### Non-Profit Owners

- ~~///~~ Section 202 loan program for projects for the elderly and handicapped (including 202/8 projects and 202/162 projects)
- ~~///~~ Section 202 Program of Supportive Housing for the Elderly
- ~~///~~ Section 811 Program of Supportive Housing for Persons with Disabilities



## Appendix 2 – Summary of Compliance Requirements

No.	Compliance Issue/ Source of Requirement	FASS SYS Code	Profit Motivated (No Section 8)	Profit Motivated (With Section 8)	Limited Distribution (No Section 8)	Limited Distribution (With Section 8)
1	Owners must promptly make all payments due for the mortgage [HUD Regulatory Agreement].	Q	X	X	X	X
2	Owner must establish a reserve for replacements account and make monthly deposits in an amount determined by HUD [HUD Regulatory Agreement].	N	X	X	X	X
3	Reserve for replacement withdrawals must be approved by HUD [HUD Regulatory Agreement].	A	X	X	X	X
4	Interest on Reserve for Replacement funds may never be disbursed directly to the owners of a project or directly to any individuals associated with the owners. All interest earned must flow through the accounts of the project and must be disclosed on the project's accounting records. (HUD Handbook 4350.1, Chapter 4).	O	X	X	X	X
5	Owners must deposit residual receipts into a separate account within 90 days of the end of the fiscal year [HUD Regulatory Agreement].	B			X	X
6	Unauthorized withdrawals of residual receipts funds [HUD Regulatory Agreement].	C			X	X
7	Residual receipts funds must be deposited in an interest bearing residual receipts account (24 CFR, Part 880 and 881).	P			X	X
8	Owners cannot encumber the project (i.e. no unauthorized liens or 2nd mortgages)[HUD Regulatory Agreement].	F	X	X	X	X
9	Owners cannot convey or transfer the property [HUD Regulatory Agreement].	E	X	X	X	X
10	Owners cannot borrow funds from the project [HUD Regulatory Agreement].	G	X	X	X	X
11	Owners cannot convey or dispose of any personal property of the project [HUD Regulatory Agreement].	Z	X	X	X	X
12	Owners cannot make or receive any distributions of assets except for allowable distributions of surplus cash [HUD Regulatory Agreement].	H	X	X	X	X
13	Owners must arrange for satisfactory management of the project and management fees cannot exceed the amount normally paid for such services. HUD must approve the fee for certain projects. Any expenses incurred with related parties should not exceed what is usual and customary [HUD Regulatory Agreement].	J	X	X	X	X
14	Owners of limited distribution properties must obtain prior authorization from HUD before retaining Excess Income and use Excess Income only for HUD authorized purposes.	L			X	X

15	Owners with subsidized tenants are responsible for accepting applications, correctly calculating the tenant's contribution toward rent and utilities and correctly calculating any subsidy. They are also responsible for completing the annual re-certification of tenant eligibility [HAP Contract and Handbook 4350.3].	Z		X		X
16	Owners are prohibited from discriminatory housing practices [HUD Regulatory Agreement, Civil Rights Act of 1968 as amended, 24 CFR 200 Subparts I and M, and Handbook 4350.3].	Z	X	X	X	X
17	Owners are required to maintain amounts collected as security deposits in a separate account apart from other project funds. The balance in the account must at all times be at least equal to all outstanding obligations under the account for security deposits (Regulatory Agreement).	M	X	X	X	X
18	Owners are obligated under the Regulatory Agreement and/or the Housing Assistance Payments Contract to maintain the physical condition of the property.	I	X	X	X	X
19	Owners are prohibited from combining project operating funds with security deposits or reserve funds. Commingling also occurs when project funds are combined with funds from other projects or businesses. (Regulatory Agreement)	D	X	X	X	X

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## Example A – Independent Auditors Report

### INDEPENDENT AUDITOR'S REPORT

To the Partners  
[the Entity]  
Anytown, U.S.A.

We have audited the accompanying balance sheet of [the Entity] as of December 31, 20XX, and the related statements of income, and changes in partners' capital and cash flows for the year then ended. These financial statements are the responsibility of [the Entity]'s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *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 [the Entity] as of December 31, 20XX, and the results of its operations and its cash flows and its changes in partners' capital for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our reports dated [Date of report] on our consideration of [the Entity]'s internal control and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The accompanying supplemental information (shown on pages xx-xxx) is presented for the purposes of additional analysis and is not a required part of the basic financial statements of [the Entity]. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects, in relation to the financial statements taken as a whole.

CPA and Company  
Certified Public Accountants

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Anytown, U.S.A.  
[Date]

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## Example B – Report on Internal Control

### INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL

To the Partners  
[the Entity]  
Anytown, U.S.A.

We have audited the financial statements of [the Entity] as of and for the year ended December 31, 20XX, and have issued our report thereon dated [Date]. We have also audited [the Entity]'s compliance with requirements applicable to HUD-assisted programs and have issued our reports thereon dated [Date].

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States and the *Consolidated Audit Guide for Audits of HUD Programs* (the "Guide"), issued by the U.S. Department of Housing and Urban Development, Office of the Inspector General. Those standards and the Guide require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and about whether [the Entity] complied with laws and regulations, noncompliance with which would be material to a HUD-assisted program.

The management of [the Entity] is responsible for establishing and maintaining effective internal control. In planning and performing our audit of the financial statements, we considered [the Entity's] internal control over financial reporting and its internal control over compliance with requirements that would have a direct and material effect on a HUD-assisted program in order to determine our auditing procedures for the purposes of expressing our opinions on the financial statements and on compliance and not to provide assurance on the internal control over financial reporting and the internal control over compliance.

We noted certain matters involving internal control and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal controls that, in our judgment, could adversely affect [the Entity's] ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements or its ability to administer HUD-assisted programs in accordance with applicable laws and regulations.

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**Report on Internal Controls**  
**Page 2**

[Include a paragraph to describe the reportable conditions noted.]

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements that would be material in relation to the financial statements being audited or that noncompliance with applicable requirements of laws and regulations that would be material in relation to a HUD-assisted program may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of internal controls would not necessarily disclose all matters in internal controls 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.

This report is intended solely for the information and use of the audit committee, management, and the Department of Housing and Urban Development and is not intended to be and should not be used by anyone other than these specified parties.

CPA and Company  
Certified Public Accountants

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Anytown, U.S.A.  
[Date]

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## Example C – Major HUD Programs Compliance Report

### INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH SPECIFIC REQUIREMENTS APPLICABLE TO MAJOR HUD PROGRAMS

To the Partners  
[the Entity]  
Anytown, U.S.A.

We have audited the compliance of [the Entity] with the specific program requirements governing [list those requirements tested] that are applicable to its major HUD-assisted program, for the year ended December 31, 20XX. Compliance with those requirements is the responsibility of [the Entity's] management. Our responsibility is to express an opinion on [the Entity's] compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the *Consolidated Audit Guide for Audits of HUD Programs* (the "Guide") issued by the U.S. Department of Housing and Urban Development, Office of the Inspector General. Those standards and the Guide require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the requirements referred to above that could have a material effect on a major HUD-assisted program occurred. An audit includes examining, on a test basis, evidence about [the Entity's] compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of [the Entity's] compliance with those requirements.

In our opinion, [the Entity] complied, in all material respects, with the requirements referred to above that are applicable to each of its major HUD-assisted programs for the year ended December 31, 20XX.

This report is intended solely for the information and use of the audit committee, management, and the Department of Housing and Urban Development and is not intended to be and should not be used by anyone other than these specified parties.

CPA and Company  
Certified Public Accountants

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Anytown, U.S.A.  
[Date]

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## Example D – Non-Major HUD Programs Compliance Report

### INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH SPECIFIC REQUIREMENTS APPLICABLE TO NON-MAJOR HUD PROGRAM TRANSACTIONS

To the Partners  
[the Entity]  
Anytown, U.S.A.

We have audited the financial statements of [the Entity] as of and for the year ended December 31, 20XX, and have issued our report thereon dated [Date of report].

In connection with that audit and with our consideration of [the Entity]'s internal control used to administer HUD programs, as required by *Consolidated Audit Guide for Audits of HUD Programs* (the "Guide") issued by the U.S. Department of Housing and Urban Development, Office of Inspector General, we selected certain transactions applicable to certain non-major HUD-assisted programs for the year ended December 31, 20XX.

As required by the Guide, we performed auditing procedures to test compliance with the requirements governing [list those requirements tested] that are applicable to those transactions. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on [the Entity]'s compliance with these requirements. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under the Guide.

This report is intended solely for the information and use of the audit committee, management, and the Department of Housing and Urban Development and is not intended to be and should not be used by anyone other than these specified parties.

CPA and Company  
Certified Public Accountants

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Anytown, U.S.A.  
[Date]

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## Example E – Fair Housing Compliance Report

### INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH SPECIFIC REQUIREMENTS APPLICABLE TO FAIR HOUSING AND NON-DISCRIMINATION

To the Partners  
[the Entity]  
Anytown, U.S.A.

We have applied procedures to test [the Entity]'s compliance with Fair Housing and Non-Discrimination requirements applicable to its HUD-assisted programs, for the year ended December 31, 20XX.

Our procedures were limited to the applicable compliance requirement described in the *Consolidated Audit Guide for Audits of HUD Programs* issued by the U.S. Department of Housing and Urban Development, Office of the Inspector General. Our procedures were substantially less in scope than an audit, the objective of which would be the expression of an opinion on [the Entity]'s compliance with the Fair Housing and Non-Discrimination requirements. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under the Guide.

This report is intended solely for the information and use of the audit committee, management, and the Department of Housing and Urban Development and is not intended to be and should not be used by anyone other than these specified parties.

CPA and Company  
Certified Public Accountants

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Anytown, U.S.A.  
[Date]

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## Example F - Schedule of Findings and Questioned Costs

### SCHEDULE OF FINDINGS AND QUESTIONED COSTS

(Should be attached to Auditor's Report on Compliance)

When the auditor identifies a finding, this schedule must include the following information for each finding, where applicable:

- ☞ The size and corresponding dollar value of the population,
- ☞ The size and dollar value of the sample tested, and
- ☞ The size and dollar value of the instances of noncompliance.

The Government Auditing Standards state that well developed findings generally consist of the following attributes:

- ☞ **Statement of condition** - the nature of the deficiencies, e.g., a regulation not being followed, a control procedure not followed or one, which is inadequate.
- ☞ **Criteria** - what the auditee should be doing, e.g. the specific regulation, a prudent management practice, or an internal control procedure.
- ☞ **Effect** - what happened as a result of the condition; this should be monetized in all possible instances and described as thoroughly as possible.
- ☞ **Cause** - why the condition exists, e.g. the auditee was unaware of the regulation or internal control was not a high priority of the auditee.
- ☞ **Recommendation** - what the auditee should do to correct the condition, normally addresses the cause (e.g. develop procedures to implement regulation or follow established procedures).

The auditor should attempt to identify the condition, criteria, effect, and cause to provide sufficient information to HUD officials to permit timely and proper corrective action. These findings may also serve as a basis for HUD to conduct additional work. In addition, as part of the finding, the auditor is required to make a recommendation for corrective action to the auditee. As part of this report, the auditor is required to include the auditee's summary comments on the findings and recommendations in the report. In addition, the auditee is responsible for developing a separate corrective action plan (see Example H) based on the auditor's findings and recommendations and should include this plan when submitting the auditor's report. If corrective action is not necessary, a statement by the auditor describing the reason it is not should accompany the audit report.

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## Example G – Auditor’s Comments on Audit Resolution Matters Relating to HUD Programs\*

The owner has not taken corrective action on findings from prior audit report, \* number and title:

**Finding No. 1-** The required documentation with regard to eligibility was not obtained for tenants receiving rent supplements.

**Status -** The owner has not obtained the required documentation from third-party sources nor has the owner reimbursed the appropriate programs. The amount of the rent supplements received for these tenants for the prior audit period was \$15,350.

**Finding No. 2 -**

**Status -**

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\* -- This includes all prior audits, program review reports and state agency reports.

\* -- The auditor may rely on management's representation as to the completeness of reports submitted during the audit period. The auditor does not have to independently confirm the completeness of audit and other reports received by the client