HUD Multifamily Accounting & Auditing Update

Fall 2017

AHACPA
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HUD Multifamily Accounting & Auditing Update

Fall 2017

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HUD Acronym Listing

ACRONYM	DEFINITION
A/E	Architect and Engineering
AAFB	Area Approved for Business
ABA	Annual Budget Authority
ACC	Annual Contributions Contract
AcSEC	Accounting Standards Executive Committee
AFHMP	Affirmative Fair Housing Marketing Plan
AFS	Annual Financial Statement
AHACPA	Affordable Housing Association of CPAs
AICPA	American Institute of Certified Public Accountants
AMP	Asset Management Project
ARC	Annual Required Contribution
ARQ	Audit Required Questions
ARRA	American Recovery and Reinvestment Act
BLI	Budget Line Item
BTA	Business-Type Activities
CA	Contract Administrator
CAAF	Coordinator Access Authorization Form
CAC	EIV Role - Contract Admin. Coordinator (HUD Staff)
CAIVRS	Credit Alert Interactive Voice Response System
CAU	EIV Role - Contract Administrator User (Non-HUD)
CEO	Chief Executive Officer
CFDA	Catalog of Federal Domestic Assistance
CFFP	Capital Fund Financing Program
CFP	Capital Fund Program
CFR	Code of Federal Regulation
CMA	Computer Matching Agreement
COCC	Central Office Cost Center
COSO	Committee of Sponsoring Organizations
CPA	Certified Public Accountant
CPE	Continuing Professional Education
DAS	Deputy Assistant Secretary
DBA	Doing Business As
DCF	Data Collection Form
DE	Direct Endorsement
DEC	Departmental Enforcement Center
DHAP	Disaster Housing Assistance Program
DVP	Disaster Voucher Program
EC	Enforcement Center (see DEC)
EIV	Enterprise Income Verification
ELI	Extremely Low Income
eLOCCS	Electronic Line of Credit Control System
FAIN	Federal Award Identification Number
Fannie Mae	Federal National Mortgage Association

ACRONYM	DEFINITION
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
FASS	Financial Assessment Subsystem
FASSMF	See FASSUB
FASS-PHA	Financial Assessment Subsystem - Public Housing Administration
FASSUB	Financial Assessment Subsystem - Submission
FDIC	Federal Deposit Insurance Corporation
FDS	Financial Data Schedule
FDT	Financial Data Template
FHA	Federal Housing Administration
FHA/MF	Federal Housing Administration/Multifamily
FMC	PIH Financial Management Center
FMD	Financial Management Division
FRAG	Financial Reporting and Auditing Guide
Freddie Mac	Federal Home Loan Mortgage Corporation
FSS	Family Self Sufficiency
FYE	Fiscal Year End
GAAFR	Governmental Accounting, Auditing, and Financial Reporting ('The Blue Book')
GAAP	Generally Accepted Accounting Principles
GAAS	Generally Accepted Auditing Standards
GAGAS	Generally Accepted Government Auditing Standards
GAO	General Accounting Office
GAS	Government Auditing Standards (see GAGAS)
GASB	Governmental Accounting Standards Board
Ginnie Mae	Government National Mortgage Association
HAP	Housing Assistance Payment
HCV	Housing Choice Voucher
HDK	EIV Role - Helpdesk Personnel
HECM	Home Equity Conversion Mortgage (Reverse mortgage)
HEREMS	Housing Enterprise Real Estate Management System
HFU	EIV Role - HUD Field Office User
HHS	Health and Human Services
HMDA	Home Mortgage Disclosure Act
HOC	HUD Homeownership Center (FHA)
HOH	Head of Household
HQA	EIV Role - HQ User Administrator
HQU	EIV Role - HUD HQ User
HSC	EIV Role - Housing Coordinator (HUD staff)
HSU	EIV Role - Non-HUD User
HUD	U.S. Department of Housing and Urban Development
HUD OIG	HUD Office of Inspector General

ACRONYM	DEFINITION
HUD PM	HUD Project Manager
HUDCAPS	HUD Central Accounting and Program System
IAR	Independent Auditor Report
IG	Inspector General
IP	Improvement Plan
IPA	Independent Public Accountant (See CPA)
KDHAP	Katrina Disaster Housing Assistance Program
LASS	Lender Assessment Subsystem
LDP	Limited Denial of Participation
LI	Low Income
LIHTC	Low-income Housing Tax Credit
LLC	Limited Liability Company
LOCOM	Lower of cost or market
M2M	Market to Market-OHMAR Restructured Loans
MAHRA	Multifamily Assisted Housing Reform and Affordability Act
MASS	Management Assessment Subsystem
MCAW	Mortgage Credit Analysis Worksheet
MD&A	Management Discussion and Analysis
MF	Mixed Finance
MFH	Multifamily Housing
MINC	Management Interactive Network Connection (Rural Housing)
MIP	Mortgage Insurance Premium
MOR	Management & Occupancy Review
MRB	Management Review Board
MTW	Moving-to-Work
NASS	iNtegrated Assessment Subsystem
NCGAS	National Council on Governmental Accounting Statement
NCUA	National Credit Union Administration
NDNH	National Directory of New Hires
NH	Nursing Home
NPO	Non Profit Organization
NRA	Net Restricted Assets
O/A	Owners / Management Agent
OAHP	Office of Affordable Housing Preservation
OCBOA	Other Comprehensive Basis of Accounting
OIG	Office of Inspector General
OIG	EIV Role - OIG User
OMB	Office of Management and Budget
ONAP	Office of Native American Programs
OPEB	Other Post Employment Benefits
P&U Division	Processing & Underwriting Division in an HOC
PASS	Physical Assessment Subsystem
PCAOB	Public Company Accounting Oversight Board
PEL	Project expense level

ACRONYM	DEFINITION
PHA	Public Housing Authority
PHAS	Public Housing Assessment System
PIC	PIH Information Center
PIH	(Office of) Public and Indian Housing
PUM/PUPM	Per-Unit per Month
QAD	Quality Assurance Division
QAR	Quality Assurance Review
QASS	Quality Assessment Subsystem
QC	Quality Control
QWHRA	Quality Housing & Work Responsibility Act
R&O	Regulatory & Operating Agreement
RA	Rental Assistance
RAD	Rental Assistance Demonstration Program
RASS	Residential Assessment Subsystem
RDA	Rural Development Agency
REAC	Real Estate Assessment Center
REMS	Real Estate Management System
RESPA	Real Estate Settlement Procedures Act
RHIIP	Rental Housing Integrity Improvement Project
RHS	Rural Housing Services
RMCR	Residential Mortgage Credit Reports
RRH	Rural Rental Housing
RSI	Required Supplementary Information
SAA	Single Audit Agency
SAC	Special Application Center
SAS	Statement on Auditing Standards
SEFA	Schedule of Expenditures of Federal Awards
SFAS	Statements of Financial Accounting Standards issued by FASB
SKE	Skills, Knowledge, Experience
SOP	Statement of Position
SSAE	Statements on Standards for Attestation Engagements
SSN	Social Security Number
SUB	REAC AFS Submitter
TAC	Technical Assistance Center
TFAE	Total Federal Awards Expended
TIN	Tax Identification Number
TPA	Transfer of Physical Assets
TRACS	Tenant Rental Assistance Certification System
TSP	Tenant Selection Plan
UAAF	User Access Authorization Form
UEL	Utility Expense Level
UFRS	Uniform Financial Reporting Standards
UI	Unemployment Benefits
UII	Unique IPA Identifier

ACRONYM	DEFINITION
URL	Uniform Resource Locator
VASH	HUD Veterans Affairs Supportive Housing Program
V-Form	Yearly Verification Report for Lender
VLI	Very Low Income
VMS	Voucher Management System
WASS	HUD's Secure Connection / Secure Systems
Yellowbook	Government Auditing Standards issued by GAO (See GAGAS)

about AHACPA

ABOUT AHACPA

HISTORY:

AHACPA was founded in 1998 to offer electronic submission services for multifamily housing as well as training. In January of 2002 Mike Olsen & Les Sparks purchased AHACPA. Since that time we have expanded submission and training services to include HUD-approved lenders and Public Housing Authorities. We increased membership from 200 member firms to over 500, and we have quadrupled the number of courses we offer.

SUBMISSIONS:

AHACPA is nationally recognized for its training, technical support, troubleshooting and electronic submission of HUD annual financial statements. Since 1998 AHACPA has submitted thousands of annual financial statements for owners, agents, and CPAs. Our submission service is efficient, timely, and cost effective. We perform the complete submission process for you, within HUD's required time frame, at a competitive fee.

TRAINING:

AHACPA has been offering continuing professional education courses throughout the United States for over 15 years. Our Multifamily courses provide audit training and HUD updates for auditors, owners & managers of HUD-subsidized multifamily properties. Lender courses provide audit training and HUD updates for auditors & owners of HUD-Approved lenders. The PHA conference provides audit training and HUD updates for PHA financial personnel, fee accountants, financial managers & auditors. AHACPA is NASBA certified.

MEMBERSHIP:

AHACPA currently has over 500 member firms. Members' benefits include technical support, access to templates & tools, and discounts at our trainings.

THE PEOPLE

LES SPARKS, PRESIDENT

Les is President of the Affordable Housing Association of Certified Public Accountants. Prior to this, Les was involved in various capacities in the software manufacturing for governmental "Case Management" systems for governmental agencies. He was the Chief Financial Officer for Professional Staff Management, a large employment services firm. Les began his career with the international accounting firm of Ernst & Young. He spent over 13 years at E&Y providing accounting, auditing and consulting services to variety of clients in many industries. Les is an accomplished trainer in both software and accounting issues. Les has a Masters of Accounting.

As president of AHACPA, Les provides support to the more than 600 members of the association. This support includes the interpretation of accounting and auditing and financial statement requirements as specified by the Department of Housing and Urban Development. Such support is provided either by phone, email or other means and is designed to assist the members in correctly reporting financial information to HUD's Real Estate Assessment Center.

Les is responsible for the development and presentation of training programs which provide continuing professional education (CPE) to auditors and other users of the relevant REAC systems. Les also supervises the

preparation of over 700 annual financial statement submissions under multifamily, public housing and FHA lender requirements.

Mike Olsen, CFO

Mike brings twenty-six years of experience in accounting, auditing, tax planning and educational program development and delivery. Mike has a Master's of Business Administration and is a Certified Public Accountant. Mike also has 12 years of specialized experience in the housing industry with a specific emphasis on the audit, financial reporting and submission requirements specifically required by the Department of Housing and Urban Development for HUD-approved lending, multifamily and public housing areas. Prior to joining AHACPA, Mike was employed by the international accounting firm of Ernst & Young for approximately 2 years and most recently has been self-employed with his own accounting and tax practice for the past 18 years. Prior to that he spent five years as Chief Financial Officer and Accounting Manager for Skaggs Management Company.

Kathy Christensen, Office Manager

Kathy has been with AHACPA from its very beginning. With over 15 years in experience with the REAC system she is one of the country's foremost experts on the submission process. She is frequently called upon by REAC for testing and trouble shooting of the multifamily submission system. Kathy has extensive background in office software solutions and is also responsible for the company's website as well as audit tools and other application development. Kathy's submission responsibilities include the receipt, logging and tracking of all multifamily submissions. She makes assignments to the keying staff and ensures that all client submitted packages are in the proper format for keying. Kathy uses her many HUD contacts to work out any submission problems that arise to ensure prompt resolution of issues preventing submission.

Susan Harris, Accounting Supervisor

Susan has been with AHACPA full time for 7 years, and for 3 years prior as data entry during peak busy season. Susan processes all the invoicing and receipts for AHACPA, and correlates all bookings and logistics for private classes. She handles all the FHA submissions, from receipt, logging and tracking until acceptance. She also assists with PHA submissions.

Other Staff:

AHACPA will also utilize other staff to assist in the timely submission of financial statements during our peak busy season time. Such individuals are selected based on the team's personal knowledge of the required skill sets including, prompt and accurate data entry as well as the judgment required to make decisions regarding issues that may arise during the submission process. Such decision making is critical in being able to complete the volume of submissions timely. These individuals are also trained to communicate any such issues to the client or the CPA for proper resolution of the matter. Each of these individuals has a minimum of 5 years experience performing multifamily submissions with AHACPA. It is likely that your account will be serviced by one dedicated staff for the majority of the submissions to ensure a consistent approach throughout.

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Membership

The Affordable Housing Association of Certified Public Accountants (AHACPA) is the premier national association providing support, training, and services for professionals of the Affordable Housing Industry and HUD-Approved Lending Industry. Our objective is to inform you of the latest HUD requirements and provide specific guidance on how to implement those requirements.

Membership Benefits

Technical Support

As a Premium AHACPA member, you have access to AHACPA's technical support. This invaluable resource can save you hours of tracking down information or trying to get guidance, direction or assistance from HUD. We have probably experienced any HUD problem you are facing. Please use the AHACPA Support Center (http://support.ahacpa.org) to post any questions. We receive tech support requests from members and non-members alike. **Our new support system will automatically give priority to AHACPA members.**

Continuing Professional Education

AHACPA offers a variety of CPE Courses. Members attending courses receive a $50 discount off the registration fee.

The Affordable Housing Conferences are held annually. These two-day Conferences feature nationally recognized speakers and representatives from HUD Multifamily and Public Housing. These speakers and representatives present sessions on the latest affordable housing revisions.

We also offer one-day update courses for Multifamily and Lenders. Course descriptions, dates and locations can be found at our Website.

AHACPA Templates

Templates are downloadable standard document files. These templates provide illustrations and workable files you can customize when producing these documents. If there is a template that you are looking for and can't locate on our website please let us know.

Analytical Review

AHACPA conducts a bi-yearly multifamily analytical review project. We collect copies of REAC submissions and compile the data for your analytical review purposes. Access to this data is limited to those that provide us with submission copies and *AHACPA members*.

Referrals

AHACPA frequently receives calls requesting referrals for a CPA firm to perform audits and peer reviews. When providing referrals we always first refer to our membership list: http://ahacpa.org/aMember/directory

Membership Dues

Membership dues are $300 annually, per office location. To sign up for membership in the AHACPA complete the Membership Registration form attached, or register online: https://ahacpa.org/aMember/signup

Other AHACPA Benefits

AHACPA Forms, Publications and Guides

Forms, Publications and Guides contain current affordable housing & lender documents. These can be found on our website separated in three sections: HUD Multifamily, Public Housing and Lenders.

Submission Services

AHACPA has submitted thousands of annual multifamily and lender financial statements for owners, agents, and CPAs. Our submission service is efficient and cost effective. We perform the complete submission process for you, within HUD's required time frame. We offer this service for multifamily and lenders. For more information on multifamily submissions contact Kathy (kathy@ahacpa.org). For more information on lender submissions contact Susan (susan@ahacpa.org).

AHACPA Newsletter

AHACPA keeps you informed of the latest affordable housing and HUD-approved lender news and updates. This news is via email in our newsletter. If you know of anyone that would like to be added to our email list please send their name and email address to info@ahacpa.org.

For more information concerning these and other services please visit our website at www.ahacpa.org.

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Membership Application

Fee of $300 per Office Location

Membership Main Contact (this is the person that will receive the renewal notice):

Name: _____ Title: _____

Firm pName: _____

Address: _____ City: _____

State: _____ Zip Code: _____

Phone Number: _____ Fax: _____

Email: _____

Please list name and email address of co-workers that want to receive AHACPA email news:

_____

_____

_____

Method of Payment:

TOTAL $_____ ☐ MasterCard ☐ Visa ☐ Discover ☐ American Express ☐ Check (address above)

Cardholder's Name _____

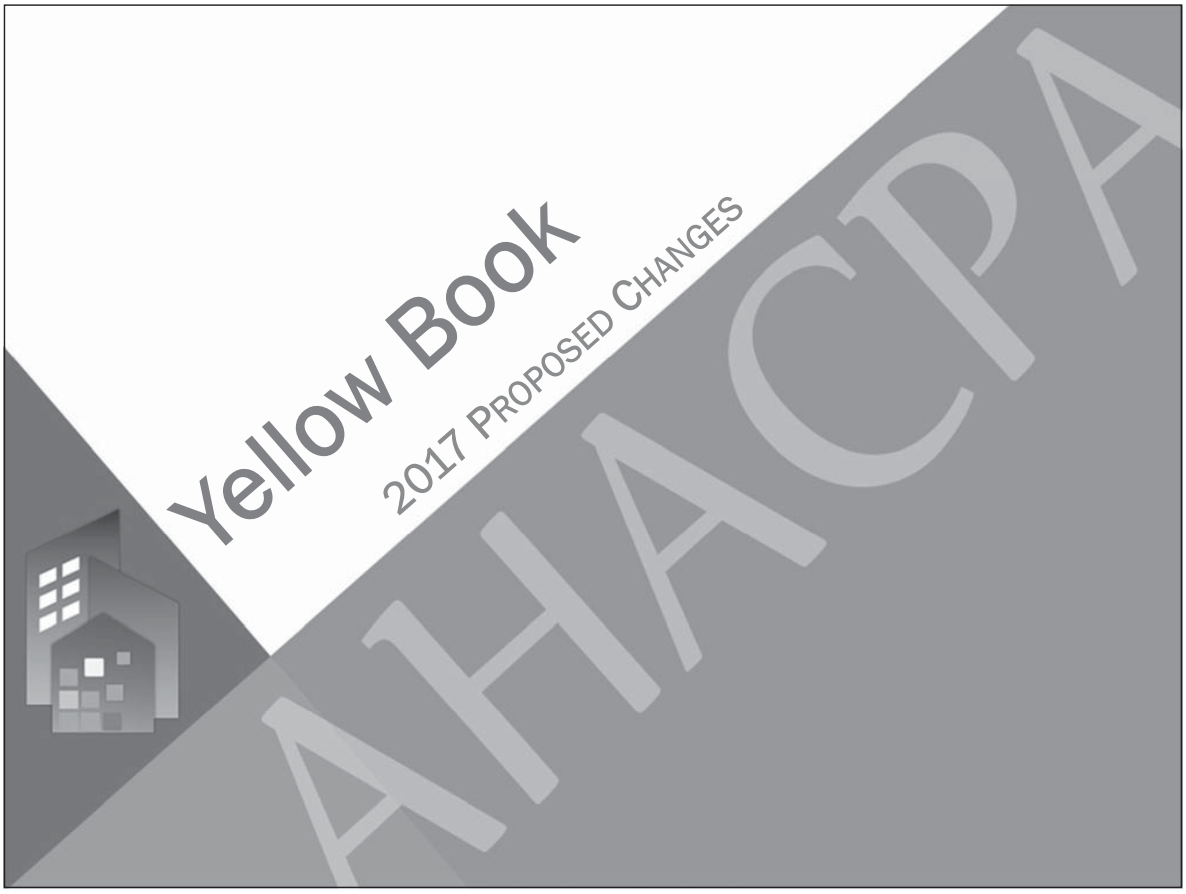
Card Number _____ CVV _____ Exp: _____

Billing Address _____

Signature _____

Email for CC Receipt _____

Section 1


Yellow Book
2017 Proposed Changes
AHACPA

Independence
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Requirements: General

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- **All audit work must be independent and remain objective and impartial.**
- Except under limited circumstances, auditors should be independent from an audited entity during:
  - Any period of time covered by the financial statements or subject matter of the engagement
  - Period of professional engagement
- Independence is comprised of:
  - Independence of Mind
  - Independence of Appearance

Conceptual Framework

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- GAGAS's consideration of independence consists of 4 related sections, providing
  - A conceptual framework for making determinations unique to specific environments; requirements
  - Guidance on independence for organizations structurally located within the entities; requirements
  - Guidance on independence for auditors providing non-audit services; and requirements
  - Guidance on documentation necessary to support adequate consideration of independence

Conceptual Framework, continued

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- GAGAS's conceptual framework helps auditors identify, evaluate, and apply safeguards to address threats to independence.
- Auditors should reevaluate threats to independence, including safeguards, whenever new information rises or changes.
- If the work of specialists are used, their independence should be assessed.
- Auditors should conclude that independence is impaired if the safeguards are not effective.
- If impaired, auditors should decline engagement.

Identifying & Evaluating Threats to Independence

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- At a minimum, auditors should identify, asses, and evaluate the following broad categories of threats to independence:
  - Self-interest threat
  - Self-review threat
  - Bias threat
  - Familiarity threat
  - Undue influence threat
  - Management participation threat
  - Structural threat (not applicable to CPA firms)

Applying Safeguards to Eliminate or Reduce Threats

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- Safeguards are controls designed to eliminate or reduce to an acceptable level threats to independence.
- Under the conceptual framework, the auditor applies safeguards that address the specific facts and circumstances under which threats to independence exist.
- The Yellow Book lists two safeguard categories:
  - Safeguards in the work environment
  - Safeguards created by the profession, legislation, or regulation

Examples of Circumstance Threats

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Self –Interest Threats	Self-Review Threats	Bias Threats	Familiarity Threats
Audit organization having undue dependence on income from a particular audited entity.	Audit organization issuing a report on the effectiveness of the operation of the systems after design or implement.	Member of the engagement team having preconceptions about the objectives of a program under audit that are strong enough to affect the auditor's objectivity.	Member of engagement team having a close/immediate family member who is a principal or senior manager of the audited entity.
Member of audit team entering employing negotiations with audited entity.	Audit organization having prepared data used to generate records that are the subject of the engagement.		Member of engagement team having close/immediate family who's employed by the entity in a position of significant influence.
Significant error found when evaluating results of previous service provided by auditor's audit organization.	Audit organization providing service or audited entity directly affecting the subject matter of the engagement.	Member of the engagement team having biases associated with political, ideological, or social convictions that result from membership or employment in, or loyalty to, a particular type of policy, group, entity, or level of government that could affect the auditor's objectivity.	Principal/employee of audited entity recently served on the engagement team.
Member of the audit team has direct financial interest in the audited entity.	A member of the engagement team being/recently been, employed by audited entity in a position to significantly influence the subject matter of the engagement.		Auditor accepting gifts or preferential treatment from an audited entity.
			Senior audit personnel having a long association with the entity.

Examples of Circumstance Threats, continued

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Undue Influence Threats	Management Participation Threats
Influence that could improperly limit/modify the scope of an engagement or threaten to do so, including pressure to reduce the extent of work performed to reduce costs/fees.	Member of the engagement team being, have been, a principal or senior manager of the audited entity.
External interference with selection/application of audit procedures or the selection of transactions examined.	Audit organization principal or employee serving as a voting member, making policy decisions affecting future direction of the program.
Unreasonable restrictions on time allotted to complete an engagement or issue the report.	Audit organization principal/employee recommending a single individual for a specific position key to the entity or program under audit.
External interference over assignment, appointment, compensation, and promotion of audit personnel.	Auditor preparing management's corrective action plan to deal with deficiencies detected in the engagement.
Restrictions on funds or resources provided to the audit organizations adversely affecting the ability to fulfill responsibilities.	**Structural Threats**
Authority to overrule/inappropriately influence auditors' judgment as to the appropriate content of the report.	External/internal auditor organizations, structural placement of the audit function within the reporting line of the areas under audit.
Threat of replacing the auditors over audit report disagreement, conclusions, or application of accounting principle or other criteria.	For internal audit organizations, administrative direction from the audited entity's management.
Influences that jeopardize the auditors' employment for reasons other than incompetence, misconduct, or the audited entity's need for GAGAS engagement.	

Acceptable Threat Level

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- A threat to independence is not an acceptable level if it either:
  - Could affect the auditors' ability to conduct an engagement without being affected by influences compromising judgment or
  - Could expose the auditors/audit organization to circumstances that would cause a third party to conclude the organization has been compromised.
- Auditors may place limited reliance on safeguards but they should not rely solely on then to eliminate or reduce threats.

Requirements: Identifying Prohibited Non-audit Services

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- Before providing non-audit service to an audited entity, auditors should determine if the service provided is a threat to independence and if the entity has an individual that can assume the responsibilities.
- If the entity is unable/unwilling to assume these responsibilities, auditors should conclude that these services are an impairment to independence.
- Auditors should conclude that management responsibilities are impairments to independence.

Application: Identifying Prohibited Non-audit Services

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- Auditors, while having a range of nonaudit services consistent with their skills/expertise, may create threats to independence.
- Effectively overseeing the service provided is a critical component of determining independence.
- The individual responsible for overseeing the management is required to have sufficient expertise, however, the management is not required to possess a specific skill to re-perform the service

Management Responsibilities 13

- Management responsibilities include:
  - Setting policies and strategic direction for the audited entity;
  - Directing and accepting responsibility for the actions of the audited entity's employees in the performance of their routine, recurring activities;
  - Having custody of an audited entity's assets;
  - Reporting to those charged with governance on behalf of management;
  - Deciding which of the audit organization's or outside third party's recommendations to implement;
  - Accepting responsibility for designing, implementing, or maintaining internal control;
  - Providing services intended for use as management's primary basis for making decisions significant to the engagement;
  - Developing an audited entity's performance measurement system when significant to the engagement; and
  - Serving as a voting member of an audited entity's management committee or board of directors

Routine Activities 14

- Routine activities typically are insignificant in terms of time incurred or resources expended and generally do not result in a specific project/engagement or formal report.
- Routine activities include:
  - Providing advice to the audited entity on accounting matters
  - Providing advice on routine business matters
  - Educating the audited entity on matters within technical expertise
  - Providing information to the entity that is readily available to the auditors

Non-Audit Services

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- For recurring engagements, having another independent audit organization audit areas affected by the non audit service may provide a safeguard to mitigate a threat to independence.
- A non-audit service otherwise prohibited by GAGAS during the period covered by financial statements may not threaten auditors' independence provided that the following exist:
  - Non-audit service was provided before the period of professional engagement;
  - Non-audit service related only to period prior to the time covered by the financial statements; and
  - The financial statements for the period to which the non-audit service relates were audited by other auditors

Non-Audit Services, continued

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Auditors providing services for entities conducting GAGAS engagements need assurance that the following functions are performed in connection with non-audit services:	In connection with non-audit services, auditors should establish & document their understanding of the management regarding:
Assumes all management responsibilities	Objectives of the non-audit service
Oversees services, designating an individual, with suitable experience	Services provided
Evaluate the adequacy and results of the services provided	Entity's acceptance of responsibilities
Accept responsibilities for the results of the services	Auditors' responsibilities
	Limitations on the provision of non-audit services

Non-Audit Services, continued

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- Some non-audit services directly support an entity's operation, and may threaten the auditor's ability to maintain independence.
- Auditors may provide non-audit services without impairing independence: (1) services are not prohibited by GAGAS, (2) specific requirements are met, and (3) significant threats have been eliminated/reduced to an acceptable level.

Preparing Accounting Records and Financial Statements

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- The following services involving preparation of accounting records impair independence:
  - Determining or changing any records without approval; authorizing/approving the entities transactions; and preparing or making changes to source documents without approval
- Apart from those defined as impairments, related services create significant threats and should be documented to eliminate/reduce. These include:
  - Recording transactions or posting coded transactions; preparing financial statements based in trial balance; posting entries approved to the entity's trial balance; and preparing account reconciliations that identify reconciling items for evaluation.
- Management is responsible for the preparation and fair presentation of financial statements.
- Consequently, an auditor's acceptance of responsibility would impair the auditor's independence.

Preparing Accounting Records and Financial Statements, continued

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- The following internal audit assistance activities impair independence:
  - Setting internal audit policies/strategic direction of activities; performing procedures that form part of the internal control; and determining the scope of the internal audit function and resulting work.
- Providing/supervising ongoing monitoring procedures impairs independence because of the management participation threat is significant.
- Some non-audit services are provided by individuals not directly involved in the operation, making possible for the auditor to provide an objective analysis.

Information Technology Services

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- IT services impair independence if they include:
  - Designing/developing an entity's financial information or IT system that will play a significant role in the management;
  - Making significant modifications to source code;
  - Supervising audited entity personnel in the daily operation; or
  - Operating an audited entity's network, financial information system, or other IT system
- IT services may aggregate data, form part of internal control, or generate information affecting the subject matter of the engagement.

Appraisal, Valuation, and Actuarial Services

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- Auditors should conclude independence is impaired (if services involve significant subjectivity, or when combined with other services are material to the financial statements) if activities include:
  - Advisory service
  - Benefit plan administration
  - Business risk consulting
  - Executive or employee recruiting
  - Investment advisory or management

DOCUMENTATION

Documentation

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- While insufficient documentation does not impair independence, auditors should prepare appropriate documentation under GAGAS requirements. Independence standard includes:
  - Document threats to independence requiring safeguards;
  - Document specific safeguards if an audit organization is located within a government entity and considered independent of said safeguards;
  - Document consideration of management's ability to effectively oversee the service; and
  - Document the auditor's understanding with an audited entity for which the auditor provides non-audit service

PROFESSIONAL JUDGEMENT

Professional Judgment

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- Professional judgment includes exercising reasonable care and professional skepticism.
- Professional judgment represents the application of all involved individuals.
- Professional judgment is important in:
  - Carrying out all professional responsibilities
  - Applying the conceptual frame work to determine independence
  - Determining the necessary level of understanding of the subject matter and circumstances
- Professional judgment does not mean eliminating all limitations/weaknesses, but rather identifying, assessing, mitigating, and concluding on them.

GAGAS Conceptual Framework for Independence

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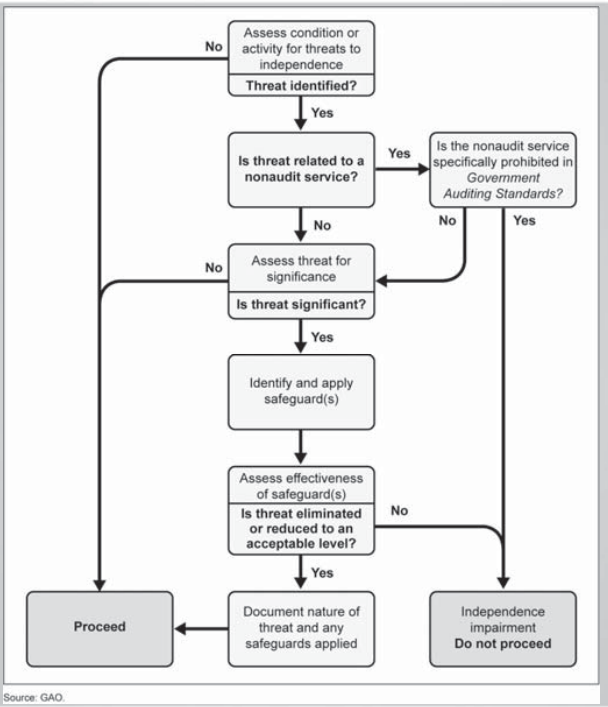

COMPETENCE

General Competence

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- Competence is knowledge about specific GAGAS requirements and having the skills/abilities to proficiently apply said knowledge to engagements.
- Audit organizations are responsible in assigning staff who are adequately trained to perform their duties.
- Specialists, if needed, are to be vetted in the same manner as general auditors in their areas of specialization.

Competence Application

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- Competence enables auditors to make sound professional judgements gained through education and experience
  - Education is developing skills, knowledge, & abilities typically conducted in academic environment.
  - Experience refers to workplace activities relevant to developing professional proficiency
- Competence is not measured by years of experience, but by a consistent commitment to on-going training throughout your career

Indicators of Competence

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- Technical knowledge and skills are needed to conduct engagements to proficiently apply:
  - GAGAS
  - Standards, statutory requirements, regulations, criteria, and guidance applicable to auditing/objectives for the engagement
  - Techniques, tools, and guidance related to professional expertise applicable to performed work

Indicators of Competence, continued

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- There are varying roles on the engagement team that require different levels of proficiency:
  - Entry level
  - Supervisory
  - Partners and directors
- Competently performing engagements involve certain key terms auditors need to follow:
  - Planning
  - Directing
  - Performing
  - Reporting

Specialists

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- Conducting engagements may require the use of specialized techniques or methods and the skill of specialists.
- Specialists may include actuaries, appraisers, attorneys, engineers, etc.
- Qualifications for specialists include:
  - Professional certification, license, other recognition
  - Reputation/standing of specialist in the views of peers
  - Previous experience and work in the subject matter
  - Auditor's prior experience in using the specialist's work
  - Knowledge of technical performance standards or other requirements in specialist field etc.

CONTINUING PROFESSIONAL EDUCATION

GAGAS Qualification

34

- Auditors working on an engagement conducted in accordance with GAGAS need to complete GAGAS qualification requirements.
  - Auditors need to complete 4 hours of CPE in GAGAS topics for qualification.
- Each level of the engagement team has varying GAGAS qualification requirements.
- For a CPE to complete the GAGAS Qualification requirement, the provider should include course content relevant to GAGAS topics to indicate the purpose to fulfill the CPE requirement.

Updating GAGAS Qualification

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- To update, auditors should complete at least 4 hours of CPE each revision of GAGAS and should be completed by the end of the 2-year CPE period.
- Auditors should complete at least 20 hours of CPE each year.
- Auditors maintain their professional competence and GAGAS Qualification completing at least 80 hours of CPE every 2 years as follows:

CPE HOURS	Subject matter categories of CPE
24 hours	Standards, statutory requirements, regulations, criteria, and guidance applicable to auditing or the objectives for the GAGAS engagement(s) being conducted (includes the 4 hours of GAGAS topics for GAGAS Qualification when applicable)
56 hours	Subject matter or topics that directly enhance the auditors' professional expertise to conduct GAGAS engagements

Subject Matter Categories of CPE

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- Auditors determine which subjects satisfy CPE requirements by considering what is needed to competently perform their assigned roles.
- Auditors taking the 4 hours in GAGAS topics may count toward the 24-hour requirement.
- Auditors need to consider future engagements when selecting specific CPE subjects to satisfy 4, 24, and 56-hour requirements.

Exemptions and Exceptions

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- Auditors hired/assigned to GAGAS engagements after the beginning of the 2-year CPE period may prorate the 24, and 56-hour requirements but not the 4-hour.
- College/university students employed on a temporary basis or enrolled in a formal program may be exempt from CPE requirements.
- With discretion, audit organizations may grant exemptions for circumstances such as ill health, maternity/paternity leave, military service, etc.

Programs/Activity Qualifying for CPE Requirements

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- CPE programs are structured activities/programs with learning objectives to maintain or enhance auditors' competence and perform work in accordance with GAGAS.

Examples of structured programs/activities qualifying for CPE	
• Internal training programs • Education/development programs presented at professional organizations • Training programs • Web-based seminars/individual-study programs • Audio conferences • Accredited university and college courses (credit and noncredit) • Meetings where a structured educational program with learning objectives presented	• Correspondence courses, individual-study guides, workbooks • Serving as a speaker, panelist, instructor, or discussion leader at programs qualifying as CPA hours • Developing materials for programs qualifying as CPE hours • Publishing articles/books contributing directly to the author's professional proficiency to conduct engagements

Measurement of CPE

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CPE credits can be earned through:

- 50 minutes of participation in group programs
- ½ CPE hours (25 minutes) but only after the 1st CPE hours ahs been earned
- Attending actual classroom time
  - 15 CPE hours each semester credit
  - 10 CPE hours each quarter credit
- 1 CPE hour for every 50 minutes of presentation time

HOURS EARNED MAY NOT EXCEED **40** HOURS

- 2 CPE hours for developing, writing, or preparing each 50 minutes of presentation
- 1 CPE hour for each hour auditors write/publish during the published year

HOURS EARNED MAY NOT EXCEED **20** HOURS

Measurement of CPE, continued

40

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- Auditors hired/assigned to a GAGAS engagement after the beginning of the 2-year CPE period may complete a prorated number of CPE hours.
- Prorated hours – based on the number of full 6-month intervals remaining in the CPE period.
- Example:
  - 2-year CPE January 1, 2015- December 31, 2016 assigns a new staff member in May 2015. Prorated CPE requirements can be calculated as follows:
    a. Full 6-month intervals remaining in the CPE period: 3
    b. Number of 6-month intervals in full 2-year period: 4
    c. Newly assigned auditor's CPE requirement: ¾ x 80 hours = 60 hours

Measurement of CPE, continued

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- For newly assigned auditors subject to 24-hour requirement, prorated hours can be calculated: ¾ x 24 = 18 hours.
- Auditors who do not complete the CPE requirements may be given additional time to do so at the audit organization's discretion.
- If the deficiency is not made up, auditors may not be able to participate in GAGAS engagements.
- If auditors charge less than 20% of their time annually, the audit organization may base the 20% on total historical or estimated changes in a year.

CPE Policies

42

- If the audit organization discontinues GAGAS engagements or reassigns to non-GAGAS assignments, auditors do not need to satisfy the CPE requirements.
- Some programs/activities do not meet CPE requirements:
  - On-the-job training
  - Basic/elementary courses
  - Programs designed for basic personal development
  - Programs generally not used in engagements
  - Programs providing training on admin. Operations
  - Business sessions with lack of learning objectives
  - Conducting external quality control reviews
  - Sitting for professional certification examinations

CPE Policies, continued

43

- Audit organization's policies/procedures for CPE may address:
  - Identifying all auditors required to meet CPE requirements
  - Providing auditors the opportunity to attend internal CPE, external CPE, or both
  - Determining which programs qualify for CPE
  - Document number of CPE hours completed
  - Monitoring auditor compliance
- Policies/procedures for documenting may address the documentation of CPE hours to satisfy requirements.

CPE Policies, continued

44

- Documenting CPE hours can be the responsibility of the individual auditors as long as there is supporting documentation.
- Documentation involves:
  - Organization name providing CPE
  - Title of program and subject matter/field of study
  - Dates attended or completed
  - Number of CPE hours earned
  - Reasons for specific exceptions granted
  - Evidence of completion
- Audit organizations do not need to prepare reports on CPE but may consider periodic reports to monitor progress.

GOING CONCERN
ASU 2014-15

ASU 2014-15

46

- Presentation in Financial Statements
- Identifying, assessing and evaluating evidence to support management's assertion
- Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern.
- Effective for ALL reporting periods ending AFTER DECEMBER 15, 2016

Prior vs. New Requirements

47

- GAAP (per FASB statements) = NONE

- GAAS (per AU-C 570)
  - Auditor MUST evaluate whether there is substantial doubt about an entity's ability to continue as a going concern
  - For a reasonable period of time not to exceed one year beyond the balance sheet date of the financial statements being issued.
  - Auditor must also consider the possible financial statement effects, including footnote disclosures on uncertainties about an entity's ability to continue as a going concern for a reasonable period of time after the balance sheet date.

- **NEW GAAP = ASU 2014-15**
- Management is responsible to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern
- For a reasonable period of time not to exceed one year beyond the date that the financial statements are issued, or are available to be issued
- Management makes an assertion which must be audited based on evidence pertaining to relevant conditions and events that are known or knowable at the date that the F/S are issued or available to be issued

Differences are Significant

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- Auditor no longer performs the going concern evaluation / assessment
- Auditor no longer determines whether or not to include footnote disclosures in the F/S
- Management makes an assertion, based on evidence (which has to be auditable) that the entity is or isn't a going concern
- Management develops the appropriate footnote disclosure(s)
- Determination date is when the F/S are issued, NOT the balance sheet date!

Evidence to be Developed by Management

49

- QUANTITATIVE
  - Current financial condition (B/S) including its liquidity sources at the date the F/S are issued
  - Projected income and cash flows
  - Unconditional and conditional obligations due or anticipated to be due within 1 year after the F/S are issued, regardless of whether those obligations are currently recognized in the F/S about to be issued
  - The funds necessary to maintain operations,
    - Current financial condition (B/S)
    - Obligations
    - Other cash flows

Evidence to be Developed by Management, continued

50

- QUALITATIVE
  - Other conditions / events when considered in conjunction with the Quantitative data listed in slide #18, which may adversely affect the entity's ability to meet its obligations within 1 year after the date that the F/S are issued.
    - Negative financial trends
    - Financial difficulties
    - Internal matters
    - External matters
      - See detailed discussion in ASC 205-45-55-2

Evidence to be Developed by Management, cont.

51

- Plans to dispose of assets or segment(s)
- Plans to borrow money or restructure debt
- Plans to reduce or delay expenditures
- Plans to increase owners equity

SAS 132

Current GAAS (pre-SAS 132) vs. ASU 2014-15

53

Issue	Current Auditing Standard	ASU 2014-15
Assessment Period	**Reasonable Period of Time:** Defined as a period not to exceed one year from the balance sheet date	One year from the date the financial statements are issued
Definition of Substantial Doubt	Undefined	Probable that the entity will be unable to meet its obligations as they become due
Assessment	Annually	Annual and interim periods

Current GAAS (pre-SAS 132) vs. ASU 2014-15, continued

54

Disclosure	Current Auditing Standard	ASU 2014-15
Disclosures: Substantial doubt alleviated by management's plans	Considered (but not required)	Required
Disclosures: Substantial doubt NOT alleviated by management's plans		Required statement that there is "substantial doubt about the entity's ability to continue as a going concern"

SAS 132: The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern

55

- Auditor should –
- Conclude whether substantial doubt exists about the ability to continue as a going concern for a reasonable period of time which is defined as
  - The period of time required by the applicable financial reporting framework
    - FASB = 12 months from the date of issuance or, the date that the financial statements were available to be issued
    - GASB = 15 months from the balance sheet date
  - Evaluate the possible financial statement effects, including the adequacy of disclosure regarding the entity's ability to continue as a going concern for a reasonable period of time.

What does it mean to "Conclude?"

56

- There must be an assertion from management or those charged with governance
- There must be audit evidence (not forms, checklists, and practice aids) provided by
  - The entity
  - Third parties
  - Direct auditor knowledge
- Appropriate, necessary, and sufficient audit procedures must have been performed on the audit evidence to form a basis for a conclusion.

SAS 132: The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern

57

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- Issued in response to ASU 2014-15
  - Applies to all audits of a complete set of financial statements (GAAP or SPF)
  - Effective for audits of financial statements covering reporting periods ending on or after December 15, 2017.

Summary of the Guidance: Auditor's Requirements

58

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- The auditor should consider whether there are conditions or events, considered in the aggregate, which raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. The auditor should determine whether management has performed an evaluation of whether such conditions or events exist.
  - If such an evaluation has been performed, then the auditor should discuss the evaluation with management, determine whether management has identified relevant conditions or events, perform appropriate audit procedures on evidence prepared by management and, if so, gain an understanding of the plans to address them
  - If such an evaluation has NOT yet been performed, then the auditor should discuss with management the justification for the intended use of the going concern basis of accounting, and inquire of management as to whether conditions or events exist that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time.

Auditor Requirements

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- Audit management's assertion
  - Checking the box on a practice aid IS NOT auditing
  - Inquiry of management is necessary BUT
    - Is not sufficient
    - Nor is it audit evidence
    - It is information needed to assess the risk that management's assertion re going concern is materially misstated.
  - Obtain schedules, calculations, worksheets and interim financial statements and cash flow analysis from the date the F/S are issued to 1 year out.
    - Audit the integrity of management's evidentiary materials
    - Audit the completeness of evidence provided by mgt.
    - Audit the mathematical accuracy

Auditor Requirements, continued

60

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- Audit management's assertion, continued
  - Work paper Documentation must contain
    - Evidence prepared by management
    - Draft of the footnote disclosure written by management
  - Work paper documentation must show what audit procedures and testing were performed and by whom
  - Work paper documentation must show who reviewed and approved the audit procedures performed
  - Conclusions reached.

Example of Audit Documentation

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- **Management's Assertion = Entity XYZ Co. IS a going concern**
- **Positive Evidence Provided by Management**
  - **Budgeted or projected income statement -cash basis [See W/P #1]**
  - **Budgeted or projected cash flow statement [See W/P #2]**
  - **Schedule of monthly obligations [See W/P #3]**
  - **Other**
- **Auditing procedures performed**
  - **Ascertain the reasonableness and feasibility of the assumptions underlying the budgeted/projected information**
  - **Determine that assumptions are properly built into the spreadsheets**
  - **Check the mathematical accuracy and completeness of all calculations**
  - **Evaluate any other data provided by the client**
- **Document the audit work paper reference where the above-listed evidence and procedures are located**

REMEMBER

62

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NO DOCUMENTATION MEANS THAT AUDIT WORK WAS NOT PERFORMED

FORMS, CHECKLISTS & PRACTICE AIDS ARE NOT AUDIT EVIDENCE

Summary of the Guidance: Auditor's Requirements

63

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- The auditor's evaluation should
  1. address management's assessment of whether there are conditions or events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern,
  2. cover the same period as that used by management in its evaluation, as required by the applicable financial reporting framework, &
  3. consider whether management's evaluation includes all relevant information of which the auditor is aware.

Summary of the Guidance: Auditor's Requirements, continued

64

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- The auditor should also inquire of management as to its knowledge of conditions or events beyond the period of management's evaluation that may have an effect on the entity's ability to continue as a going concern.
- When events or conditions have been identified, the auditor should obtain sufficient appropriate audit evidence to determine whether such conditions and events, when considered in the aggregate, raise substantial doubt about an entity's ability to continue as a going concern by performing additional audit procedures, including consideration of mitigating factors.

Summary of the Guidance: Auditor's Requirements, continued

65

AHACPA

- When management's plans include financial support by third parties or the entity's owner-manager (the supporting parties) and such support is necessary to support management's assertions about the entity's ability to continue as a going concern, the auditor should obtain sufficient appropriate audit evidence regarding
  1. the intent of the supporting parties to provide the necessary financial support, including written evidence of such intent, and
  2. the ability of the supporting parties to provide the necessary financial support.
- Note that failure to obtain the written evidence of the intentions of the supporting parties to provide financial support constitutes a lack of sufficient appropriate audit evidence, in which case the auditor should conclude that management's plans are insufficient to alleviate the determination that substantial doubt exists about the entity's ability to continue as a going concern.

Summary of the Guidance: Auditor's Requirements, continued

66

AHACPA

- If the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances, but substantial doubt exists about the entity's ability to continue as a going concern, then the auditor should evaluate the adequacy of the financial statement disclosures, as required by the applicable financial reporting framework.
- If conditions or events, considered in the aggregate, have been identified that raise substantial doubt about the entity's ability to continue as a going concern, but, based on the audit evidence obtained, the auditor concludes that substantial doubt has been alleviated by management's plans, then the auditor should evaluate the adequacy of the financial statement disclosures required by the applicable financial reporting framework.

Summary of the Guidance: Auditor's Report

67

AHACPA

- If the financial statements have been prepared using the going concern basis of accounting, but, in the auditor's judgment, management's use of the going concern basis is inappropriate, then the auditor should express an adverse opinion.
- If, after considering identified conditions or events and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern remains, the auditor should include an emphasis-of-matter paragraph in the auditor's report, which should be expressed in terms consistent with those included in the applicable financial reporting framework.

Summary of the Guidance: Auditor's Report, continued

68

AHACPA

- If adequate disclosure about an entity's ability to continue as a going concern is not made in the financial statements, then the auditor should express a qualified opinion, or an adverse opinion, as appropriate.
- If substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time existed at the date of prior-period financial statements that are presented for comparative purposes and that doubt has been removed in the current period, then the emphasis-of-matter paragraph included in the auditor's report on the financial statements of the previous period should not be repeated.

Summary of the Guidance: Auditor's Report, continued

69

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- Management may request that the auditor reissue an auditor's report and eliminate a going concern emphasis-of-matter paragraph contained therein.
- Although an auditor has no obligation to reissue the report, if the auditor decides to reissue the report, then the auditor should reassess the going concern status of the entity.

Summary of the Guidance Other Matters

70

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- Unless such individuals are involved in managing the entity, the auditor should communicate with those charged with governance regarding conditions and events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time.
- If there is significant delay in the expected issuance of the financial statements by management or those charged with governance, and the auditor believes that the delay could be related to the evaluation of whether there is substantial doubt about the entity's ability to continue as a going concern, then the auditor should perform additional audit procedures as necessary.

Summary of the Guidance Other Matters, continued

71

- Documentation requirements when there is substantial doubt about the entity's ability to continue as a going concern:
  1. the conditions or events that led the auditor to conclude that substantial doubt exists,
  2. the elements of management's plans that the auditor considered to be particularly significant in overcoming conditions or events that raised doubts about the entity's ability to continue as a going concern,
  3. the audit procedures performed to evaluate the significant elements of management's plans and the evidence obtained,
  4. the auditor's conclusion regarding whether substantial doubt about the entity's ability to continue as a going concern remains or is alleviated, and
  5. the effect of the auditor's conclusion on the auditor's report.

Example Emphasis-of-Matter Paragraph: Management's Plans Do Not Alleviate Substantial Doubt

72

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations, has a net capital deficiency, and has stated that substantial doubt exists about the Company's ability to continue as a going concern. Management's evaluation of the events and conditions and management's plans regarding these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

Example Emphasis-of-Matter Paragraph: Management's Plans Alleviate the Substantial Doubt (optional)

73

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As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency. Management's evaluation of the events and conditions and management's plans to mitigate these matters are also described in Note X. Our opinion is not modified with respect to this matter.

Section 2

Financial and Compliance
Auditing Update
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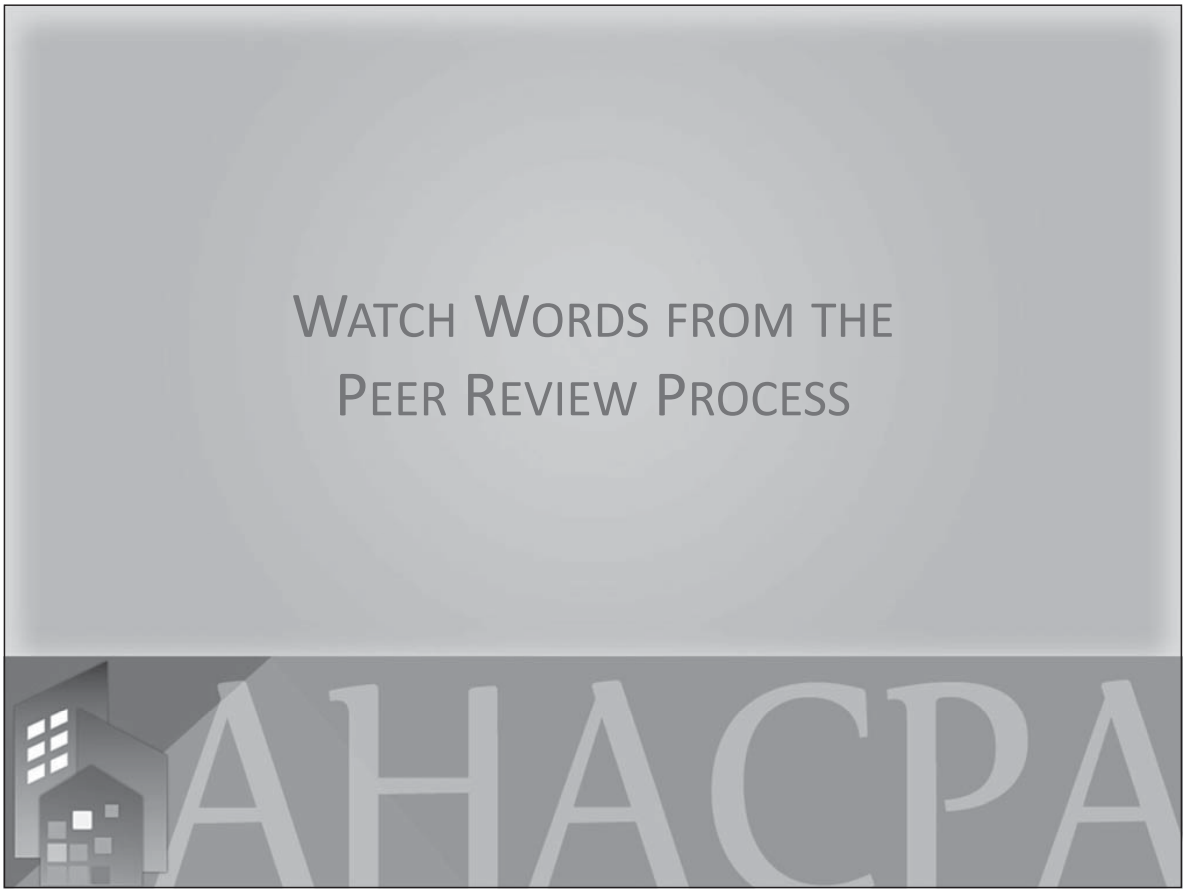
WATCH WORDS FROM THE
PEER REVIEW PROCESS
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Peer Review

3

- NOT DOCUMENTED = NOT PERFORMED
- Vendor-obtained practice aids, checklists and forms are NOT audit evidence
- Sources of audit evidence
  - Books, records, data, etc. generated by the entity being audited
  - Information obtained from third parties who do business with the entity
  - Direct auditor knowledge

Audit Documentation

4

- AU-C 230, Audit Documentation, requires the auditor to document the nature, timing, and extent of all audit procedures performed by recording –
  - The identifying characteristics of the specific items or matters tested;
  - Who performed the audit work and the date such work was completed; and
  - Who reviewed the audit work performed and the date and extent of such review.

Audit Documentation, continued

5

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- Factors to consider in determining the nature and extent of documentation:
  - Risk of material misstatement associated with account or class of transaction
  - Extent of judgment involved in performing the work and evaluating the results
  - Nature of the auditing procedures
  - Significance of the evidence to the assertion being tested nature and extent of exceptions
  - Need to document conclusion or basis of conclusion when not readily determinable

Audit Documentation, continued

6

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- Requires audit documentation to include abstracts or copies of significant contracts & agreements if needed to aid the experienced auditor in understanding work performed & conclusions reached
- Requires that documentation specifically identify items tested
- Requires documentation of any departures from auditing standards & the sufficiency of alternative procedures used to compensate for the objectives of the requirement

Audit Documentation, continued

7

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- AU-C section 230, *Audit Documentation*
  - Audit documentation should include audit plans, forms, checklists, and other practice aids.
- The existence of an adequately documented audit plan demonstrates that the auditor has planned the audit.
  - Tailoring of canned audit plans, forms and checklists is mandatory
- The audit plan ONLY supports the fact that the audit was planned, NOT that specific procedures were performed.

Audit Documentation, continued

8

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- Checklists and canned forms can be used to facilitate audit procedures, but, using them correctly requires that they be appropriately tailored for the specific audit.
  - However, they are NOT audit evidence.
- Checking off a step in an audit program or a checklist does not provide sufficient documentation about the nature, timing, and extent of audit procedures performed or the identifying characteristics of the specific items or matters tested.

Common Engagement Deficiencies

Professional Standards

10

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- Failure to appropriately document planning procedures, including:
  - Risk assessment (and linkage of risks to procedures performed)
  - Planning analytics
  - Understanding of IT environment
  - Internal control testing

Professional Standards, continued

11

- Failure to appropriately address fraud considerations
- Failure to communicate and/or document required communications with those charged with governance
- Failure to include audit documentation that contains sufficient competent evidence to support the firm's opinion on the financial statements
- Failure to address the reason(s) accounts receivable were not confirmed
- Failure to adequately document sampling methodology
- Failure to document consideration of the group audit standard

Single Audit Peer Review Deficiencies

12

Examples of the issues that arise that cause the team captain to consider whether a firm should perform additional audit procedures and reissue the prior year single audit reporting include the following:

1. Missed major program due to using preliminary expenditures when final numbers were higher.
2. Improper clustering of programs resulting in a missed major program
3. Failure to include and audit all programs with same catalog for domestic federal assistance (CFDA) number when determining major programs
4. Failure to properly perform Type A & B program risk assessments
5. Failure to properly compute the program type A/B threshold determination resulting in a missed major program or incorrect program selection
6. Improperly classifying an entity as a low-risk auditee resulting in missed major programs due to percentage of coverage audited as major (watch the 30 day rule)

Single Audit Peer Review Deficiencies, continued

13

7. Inadequate testing of internal over compliance (for example, not testing to support a low assessed level of control risk, not testing controls relating to some direct and material compliance requirements, or inappropriate sample sizes or related documentation) or compliance (for example, failure to test compliance for all direct and material compliance requirements or inappropriate sample sizes or related documentation) to support the major program opinion
8. Failure to document an understanding of internal control over compliance of federal awards sufficient to plan the audit to support low assessed level of control risk for major programs, including consideration of risk of material noncompliance (materiality) related to each applicable compliance requirement and major program
9. Failure to document the adequacy of the planned sample size for test of controls over compliance to achieve a low level of control risk
10. Failure to document the testing of controls and compliance for the relevant assertions related to each applicable compliance requirement with a direct and material effect for the major program, including insufficient documentation and usage of dual-purpose testing.
11. Failure to document internal controls over the preparation of the Schedule of Federal Awards (SEFA).

Peer Reviewer Focus – Inherent Risk

14

- ***Guidance***
  - In large, major accounts and audit areas, the inherent risk is rarely low. Low risk may come from a relatively small balance or it may be low on a specific assertion (for example, currency valuation risk when only one currency is involved). Note: Unless controls are tested and determined to be effective, the risk of material misstatement is, essentially, equivalent to inherent risk, even though they may be assessed as required in AU-C sec. 315.
- ***Question***
  - *Revision for 2016*: Where RMM for any relevant assertions or significant accounts is indicative of an IR assessment set at less than high, is there a reasonable basis for that assessment? [AU-C sec. 315.03 and AAG-ARR sec.3.23 and 5.70] Consider: discussions amount the engagement team, key elements of their understanding obtained regarding each aspect of the entity and its environment, and any significant decisions reached or a separately documented IR assessment, if applicable.

Peer Reviewer Focus – Control Risk

15

Guidance

An assessment of control design and implementation is required on every audit, whether or not controls are tested and relied on. Specifics regarding the account being reviewed should consider the inherent risks and whether specific controls exist to address the inherent risk by assertion.

Question

Consider the relevant assertions and risks related to the account or audit area. Did the auditor evaluate the design and implementation of relevant controls in this area? [AU -C sec. 315] Consider the following:

- Documentation includes actual controls and **not just process descriptions**
- In addition, are all the following present in the documentation:
  - Who performed the procedure and when
  - Who in the client organization was interviewed
  - What evidence regarding the control was examined during the procedure

Peer Reviewer Focus – Control Risk, continued

16

Question

If control risk is assessed at less than high, has evidence been obtained to support the level of reliance planned, as follows:

- If the auditor is relying on a service auditor's report, did the auditor substantively meet professional requirements regarding internal control, including those detailed at AI35 of this checklist? [AU-C sec. 402)
- For controls where sampling is planned, is the level of testing sufficient to support the level of planned reliance (considering the parameters of risk, tolerable rate, expected rate, and population size) [AU-C sec. 330.07-.10] [AAGARR sec. 5.69]
- For controls not involving sampling (for example, governance assessments) has sufficient evidence been gathered to support the level of planned reliance? [AUC sec. 330.07-.10, AAG-ARR sec. 5.70]

Peer Review Findings Yellow Book 17

- No tailoring of management rep letter
- Missing Yellow Book report
- YB report missing findings
  - internal controls
  - Non-compliance
  - Questioned costs
- Inappropriate restricted use paragraph
- Reports of other auditors omitted

Internal Control per the Yellow Book Documentation and Testing 18

- Compliance with laws, regulations, contracts, and agreements
  - Controls to ensure compliance with Federal, state, and local laws and regulations, both general and specific to the industry and operations of the entity
  - Controls to ensure compliance with specific provisions of contracts and agreements
  - Monitoring of compliance with LRCA
  - Personnel, systems, and technology competent and accountable for compliance with LRCA
  - Controls document compliance with specific provisions of contracts and agreements

AU-C 315 Paragraph 14

19

When obtaining an understanding of controls that are relevant to the audit, the auditor should evaluate the design of those controls and determine whether they have been implemented by performing procedures in addition to inquiry of the entity's personnel.

Q & A on Paragraph 14

20

Does an understanding of controls relevant to the audit require an assessment of design and confirmation of implementation for all relevant controls every year?

- Yes
- Combination of inquiries and other corroborating procedures
- Flexibility in what is performed each year

AU-C 315 Paragraph 19

21

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- The auditor should obtain an understanding of the information system, including the related business processes relevant to financial reporting, including the following areas:
  a. The classes of transactions in the entity's operations that are significant to the financial statements.
  b. The procedures within both IT and manual systems by which those transactions are initiated, authorized, recorded, processed, corrected as necessary, transferred to the general ledger, and reported in the financial statements.
  c. The related accounting records supporting information and specific accounts in the financial statements that are used to initiate, authorize, record, process, and report transactions. This includes the correction of incorrect information and how information is transferred to the general ledger. The records may be in either manual or electronic form.

AU-C 315 Paragraph 19, continued

22

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- The auditor should obtain an understanding of the information system, including the related business processes relevant to financial reporting, including the following areas:
  d. How the information system captures events and conditions, other than transactions, that are significant to the financial statements.
  e. The financial reporting process used to prepare the entity's financial statements, including significant accounting estimates and disclosures.
  f. Controls surrounding journal entries, including nonstandard journal entries used to record nonrecurring, unusual transactions, or adjustments.

Q & A on Paragraph 19

23

- Does the auditor have to obtain an understanding of business processes relevant to financial reporting and communication in every engagement?
  - Yes!
  - Processes versus controls

AU-C 315 Paragraph 21

24

- *Control activities relevant to the audit*. The auditor should obtain an understanding of control activities relevant to the audit, which are those control activities the auditor judges it necessary to understand in order to assess the risks of material misstatement at the assertion level and design further audit procedures responsive to assessed risks. An audit does not require an understanding of all the control activities related to each significant class of transactions, account balance, and disclosure in the financial statements or to every assertion relevant to them. However, the auditor should obtain an understanding of the process of reconciling detailed records to the general ledger for material account balances.

Q&A on Paragraph 21

25

- What are control activities relevant to the audit (CARA)?
  - Judgment
    - Factors to consider include, among others, materiality, risk and complexity of systems
    - Auditor's knowledge
    - Management's review controls
    - Controls around data and information produced by the entity
  - Requirement
    - Controls that address significant risks of material misstatement
    - Controls that address risks of material misstatement for which substantive procedures alone are not sufficient
    - Controls on which the auditor plans to rely to design substantive procedures
    - Controls over journal entries

AU-C 315 Paragraph 26

26

- To determine the further audit procedures the auditor should identify the risks of material misstatement at:
  - The financial statement level and,
  - The relevant assertion level for classes of:
    - Transactions
    - Account balances
    - Disclosures

AU-C 315 Paragraph 27

27

- For the risk assessment the auditor should:
  - Identify risk throughout understanding of the entity and its environment, including controls by considering classes of transactions, account balances and disclosures in the AFS
  - Assess the identified risks and evaluate whether they relate more pervasively to the AFS as a whole and potentially many assertions
  - Relate the risks to what can go wrong at the relevant assertion level
  - Consider the likelihood of material misstatement, including the possibility of multiple misstatements, and whether the potential misstatement could result in material misstatement

AU-C 315 Paragraph 28

28

- As part of the risk assessment described in paragraph .26, the auditor should determine whether any of the risks identified are, in the auditor's professional judgment, a significant risk. In exercising this judgment, the auditor should exclude the effects of identified controls related to the risk.

AU-C 315 Paragraph 29

29

- In exercising professional judgment about which risks are significant risks, the auditor should consider at least:
  - Whether there is a risk of fraud
  - Whether the risk is related to recent significant economic, accounting or other developments
  - Complex transactions
  - Involves significant related party transactions
  - Degree of subjectivity in the measurement of financial information related to the risk, especially those related to uncertainties
  - Significant transaction outside the normal course of business

Testing Controls

30

- Five elements of COSO
  - Evaluate design
  - Test effectiveness of key control attributes (not processes)
    - Inspection and re-performance
    - Procedures consistently performed, by the right person, in accordance to policy, and prevents management override
    - Must test throughout the period
    - Deviations must be defined and documented in advance of the test
    - Determine if expansion of the sample with provide evidence of containment of the error

Peer Review Sampling Issues

31

- Sampling issues appearing in “deeper dive” peer reviews
- Methods of defensible sample size determination
  - Critical issues
    - Sample Size – control, substantive, compliance
    - Sufficient evidence for low-risk opinion
    - Consequences
  - Second level issues
    - Documentation issues
    - Confusion on Single Audit and HUD
    - Applications
  - Effects in Quality and Peer Reviews

Remember the Basics

32

- Principles – parameters and relationships overall framework
- Controls – deviation rates, determining effectiveness
- Substantive – projection to population
- Audit Risk Model = IR X CR = RMM
  - Inherent risk (IR)
  - Control risk (IC)
  - Analytical review procedure risk (AP)
  - Substantive TOD risk of detection (TD)
- APPLIED BY ACCOUNT & ASSERTION

Sampling In Single Audit/HUD

33

- Sampling is mandatory in both the Single Audit Compliance Supplement and the HUD Audit Guide
  - Samples in both include
    - Tenant files
    - Cash disbursements
    - R4R releases
    - A few others
  - HUD Audit Guide may also include
    - Work orders
    - Cash receipts
    - Releases from the wait list
- Follow AU-C 530, Audit Sampling

Objectives in Sampling

34

- Dual purpose sampling
  - Controls over compliance
  - Determining compliance
- Attempting to detect known questioned costs >$25,000 mandatory reporting
  - Required to report known questioned costs,
  - However, likely questioned costs affect the overall report
- Generally it is not possible to combine compliance testing with financial statement testing

Known versus Likely Questioned Costs (Single Audit Only)

35

AHACPA

UG 200.516

- (3) **Known questioned costs that are greater than $25,000 for a type of compliance requirements for a major program**. Known questioned costs are those specifically identified by the auditor. *In evaluating the effect of questioned costs on the opinion on compliance, the auditor considers the best estimate of total costs questioned (likely questioned costs), not just the questioned costs specifically identified (known questioned costs).* **The auditor must also report known questioned costs when likely questioned costs are greater than $25,000 for a type of compliance requirement for a major program.** In reporting questioned costs, the auditor must include information to provide proper perspective for judging the prevalence and consequences of the questioned costs.

Preparing for An Adequate Sample

36

AHACPA

- Analytical review procedures
- Scanning
- Applying procedures to entire population
- Testing key items
  - May use judgment in determining
  - Focus on materiality
  - May eliminate sample altogether due to reduced detection risk
  - May not be effective when using to test multiple attributes
- Procedures to clarify understanding of IC over compliance is not sampling

Sampling – Define Population

37

AHACPA

- Sampling unit and population should be consistent with the objective
  - For example payroll testing may very based on whether costs are direct or indirect
- Focus on transactions of interest (may be subset of original population)
- Representative – Sample may be revisited if it does not contain sufficient sample items
- Sampling Unit –defined by the individual items constituting the population, eg., tenant file or cash disbursements (Attributes of each item being testing are not sampling units)

Multiple Organizational Units

(Single Audit Only for Compliance) paragraph 21.45

38

21.45

If controls over compliance or compliance procedures at the various organizational units vary significantly, it may be necessary for each location to be considered a separate population. When transactions relating to types of compliance requirements are processed in organizational units using the same controls [fn 9] or compliance procedures are performed under common oversight and monitoring, it may be feasible for the auditor to obtain sufficient appropriate audit evidence about controls and compliance for major programs by selecting one overall sample across the organizational units (for example, selecting from centralized locations or visiting all organizational units). When it is not feasible to obtain the evidence centrally or to visit all the organizational units, and controls or compliance procedures, or both, are the same across organizational units, the auditor generally will select some organizational units from which to obtain audit evidence. In this case, the auditor may consider (*a*) testing the minimum sample size at each location of significance (or more than the minimum sample size depending on the results of risk assessment procedures preceding sampling) or (*b*) varying the selection of the less significant organizational units included in the testing from year to year. Appendix E, "Multilocation Sampling Considerations," of the AICPA Audit Guide *Audit Sampling* provides useful guidance in determining the appropriate organizational unit to visit, as well as implications on sample size.

Sample Sizes

39

- Size of population has little impact on sample sizes, except for smaller populations
- Controls Testing
  - Identify characteristics indicating performance of control
  - Deviation is a departure from the expected performance of the control (departure from Federal rules or contract conditions
  - Defined for each audit objective
- Compliance Testing
  - Determine whether deviations constitute a finding and its effect on compliance opinion

Dual Purpose Sampling

40

- Covers both testing of effectiveness of internal control over compliance and whether auditee complied with relevant compliance requirements
- Same sampling unit
- Size will generally be the larger of the two required samples
- Failure of a control may not lead to noncompliance
- Findings evaluated separately
- Documentation clearly distinguishes between controls and compliance testing

Combining Compliance and AFS Samples (paragraph 21.56)

41

AHACPA

21.56

Another example of using a sample for multiple purposes is when auditors wish to use a single sample for testing for both Uniform Guidance compliance audit objectives and financial statement audit objectives. Such an approach may present additional complexities to consider because often there are different characteristics, and even different appropriate populations, for single audit and financial statement audit tests. Although many auditees record federal award transactions within their general ledgers, populations used for financial statement purposes often do not align well with sampling populations for testing in a Uniform Guidance compliance audit. The same principles described previously for a dual purpose sample apply when a single sample is used to achieve both Uniform Guidance compliance audit and financial statement audit objectives.

Combining Compliance and AFS Samples (paragraph 21.56), continued

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AHACPA

21.57

Although it is challenging to select samples that achieve both Uniform Guidance compliance audit and financial statement objectives, they do occur. An example of a sample that achieves both Uniform Guidance compliance audit and financial statement audit objectives is a sample of transactions inspected to determine the following:

- Indications of compliance with relevant federal statutes, regulations, and compliance requirements over allowable costs and cost principles
- Indications of performance of internal controls over both allowable costs and cost principles and appropriateness of the expense for financial reporting
- Evidence that the recorded amount, account, and period are correct for financial reporting

Controls Sample Size

43

AHACPA

- Planned to a low assess level of risk
- Accordingly, a 90-95% confidence level
- High level of assurance
- Appropriate for populations of greater > 250

Significance of Control and Inherent Risk of Compliance Requirement 0 deviations expected	*Minimum Sample Size*
Very significant and higher inherent risk	60
Very significant and limited inherent risk or Moderately significant and higher inherent risk	40
Moderately significant and limited inherent risk	25

SECTION 3

HUD Audit Guide – Chapter 3
HUD Multifamily Housing Programs

[Text in this font is information from the new Chapter 3. Text in this font is guidance from other sources.]

3-1. BACKGROUND. This chapter contains the U.S. Department of Housing and Urban Development's (HUD) requirements for conducting the compliance portion of the annual financial audits of profit-motivated and limited-distribution entities participating in HUD's Federal Housing Administration (FHA) multifamily housing programs *except for hospitals, which are covered by chapter 4 of this guide. **For audits performed under this chapter, which include many different types of projects, the required compliance testing must be done for each project on an individual basis except when the project is owned and/or managed by an entity that owns and/or manages multiple HUD/FHA-assisted projects. When this condition exists, audit guide compliance sections, paragraph 3-5.J, Tenant Application, Eligibility, and Recertification; paragraph 3-5.L, Tenant Security Deposits; and paragraph 3-5.M, Management Functions,** can be audited on an individual project basis or can be sampled using a group project-basis sample (defined later in this section) if

1

2

A. The same system is used by management for the compliance section for all projects selected for inclusion in this group project-based sample.

AHACPA Note – The definition of what constitutes a "same system" has not been outlined by the OIG. The degree of acceptability could vary by practitioner. The auditor is cautioned to exercise professional judgment in making this assessment.

B. For the projects that are to be included in the population and sample, the compliance section has the same supervisor for all projects, the procedures followed are identical, and the test of internal controls did not disclose any weaknesses.

C. The owner(s) agrees to the project-based sample method.

AHACPA Note – The consensus among practitioners is that this approval is best documented in the engagement letter. If the engagement letter is signed by the management company, s separate letter must be obtained by the CPA from the owner agreeing to the group-based sample. Further, owners and CPAs should be aware of the potential finding consequences due to non-compliance of other owners in the sample that could impact their compliance reports.

D. The auditor fully documents in the work papers the above information upon which the determination was made, including the owner's signed agreement.

3

All other compliance sections except for the three cited above must be performed on each project.

When a condition or weakness is found during the testing that is required to be reported, it must be reported in the audit report for each project in the population. Reference should be made to each report that contains that type finding. If dollars are

involved, only the dollars belonging to that specific project should be included in that project's audit finding. For example, significant deficiencies found or findings developed must be included in the audit report for all projects that were grouped for the group project-based population. The following illustrates wording that can be used. *"This internal control problem applies to and is reported in 15 audit reports, 5 for projects owned by companies related to the X Housing Cooperation and 10 projects owned by two unrelated owners. The total disallowed cost is $450,000, of which $100,000 applies to this project, and $200,000 applies to the other 4 projects owned by companies related to the X Housing Cooperation and $150,000 applies to the 10 projects owned by the two unrelated owners.*" Additionally, nonmaterial instances of noncompliance must be reported in a management letter or other written correspondence for each project in the population (reporting requirements are included in paragraph 3-8 of this chapter).

AHACPA Note – In accordance with the guidance contained in the transmittal letter to the Guide, management letters are now to be provided to HUD in the REAC submission. This process will be discussed in paragraph 3-8 following.

Also, auditors will be able to convey nonmaterial instances of noncompliance to management via a management letter or other type of auditor-written communication as long as the requirements of chapter 2, paragraph F, are followed. Chapter 2 requirements provide that the existence of a management letter or other type of auditor communication must be mentioned in the independent auditor's report, the date of issuance is to be included, and those letters/communications must be provided to HUD with the audit report package.

4

A group project-based sample must include at least 20 percent of the projects with no less than a minimum of four projects to be reviewed each year for compliance with audit steps contained in sections 3-5J, 3-5L, and 3-5M. This will result in each project in the population being reviewed at least every five years or less for those compliance sections. The following examples illustrate this point:

Example 1. An auditor has 50 projects in the population that are to be audited, and the conditions permit the auditor to use group project-based sampling. The auditor would test 20 percent or 10 projects since this amount is greater than four.

Example 2. An auditor has 10 projects in the population that are to be audited, and the conditions permit the auditor to use group project-based sampling. The auditor would test the minimum of four projects since 20 percent would only be two projects.

AHACPA Note – The provision to require at least 20% of the projects in the sample should not be interpreted as a mandate to sample in this fashion or to preclude samples containing the entire population. This provision simply sets a minimum percentage of projects to be included if the auditor elects to sample in this manner. As a result of the above provision, each project should be included in a sample at least once every 5 years. Therefore, if a randomly selected sample of the entire population of projects did

not result in every project being sampled within the 5-year period, that project would have to be included in the sample in the fifth year.

5

Specific projects from the population may be added to the sample based on a risk analysis or for any other reason. However, any specific project shall not be counted as a part of the 20 percent or minimum sample of four for that year.

AHACPA Note – Samples may be stratified. If the auditor knows that certain projects have specific, known weaknesses in internal control or with compliance, the auditor could elect to test these projects on a stand-alone basis and not include them in the group project sample. However, as noted above, projects so removed cannot qualify for the 20% minimum testing requirement.

If the auditor elects to use the project-based sampling method, the sampling schedule and system for selecting must be included in the work papers so auditors can later ensure that all projects in the population will continue to be audited systematically.

AHACPA Note –Obviously, this requirement places an additional documentation requirement on the CPA. Workpaper documentation must include sufficient detail to document the 5-year sampling requirement.

The auditor's opinion on compliance is to be provided for each individual project, and the compliance testing must support the opinion for each individual project and not the group as a whole.

Practitioners with nonprofit projects as clients, who participate in HUD/FHA multifamily housing programs covered by the Single Audit Act, are to conduct audits in accordance with Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*, and with the requirements contained in OMB Circular A-133's, *Compliance Supplement,* which can be found on the OMB Web site

http://www.whitehouse.gov/omb/grants/grants_circulars.html

This chapter is not intended to be a program-specific audit guide for compliance with the A-133 requirements. If the *Compliance Supplement* includes the program that is being audited, the guidance in the supplement is to be used. If the *Compliance Supplement* does not include the program that is being audited, part 7 of the supplement provides guidance on how to identify the applicable compliance requirements to test. Paragraph 1d of part 7 states "If there is an audit guidance issued by the Federal agency's Office of Inspector General (OIG), the auditor may wish to consider this guidance in identifying the program objectives, program procedures, and compliance requirements." This guide should be used only for that purpose.

3-2. REFERENCE MATERIAL. The following is the reference material that was in effect at the time this audit guide was issued. It is the auditor's responsibility to use the procedures that were in effect during the period covered by the audit.

The audit procedures that are established in this guide are based on the procedures that were in effect when the guide was written. The auditor must determine the procedures that were in effect during the audit period which their client was to follow. The auditor must conform those procedures to the audit steps in this guide. Changes, as found necessary, must be made to the audit steps.

Throughout this chapter, reference is made to handbooks, using the base handbook number without the revision number (i.e., REV-1, REV-6, etc.). This will enable periodic updates to paragraph 3-2 should any of the material referenced below be revised, causing a change to documents' revision number, rather than revising the entire handbook/chapter, since the base handbook number would not change. Also, the auditor should ensure that the updated reference, listed in this paragraph, is used for performing the audit. The versions listed below were those in effect at the time this audit guide was issued. If reference to a handbook is needed in the audit report, the auditor should ensure that the entire updated reference, including the current revision number, is used.

Document	Title
HUD Handbook 4370.2, REV-1	Financial Operations and Accounting Procedures for Insured Multifamily Projects*

*HUD Handbook 4350.3, REV-1	Occupancy Requirements of Subsidized Multifamily Housing Programs
HUD Handbook 4370.1, REV-2	Reviewing Annual and Monthly Financial Statements
HUD Handbook 4381.5 REV-2 CHG-2	The Management Agent Handbook
HUD Handbook 4350.1	Multifamily Asset Management and Project Servicing
Not numbered	M2M Program Operating Procedures Guide Located at Web site: http://www.hud.gov/offices/hsg/omhar/readingrm/opglinks.cfm

Reference material may be obtained by accessing HUD's Client Information and Policy System (HUDCLIPS) at the following Web site:

http://www.hudclips.org/

Reference material may also be ordered from HUD's direct distribution system by telephone, (800) 767-7468; in a letter addressed to HUD, Customer Service Center, Room B-100, 451 Seventh St., SW, Washington, DC 20410; or by fax, (202) 708-2313.*

3-9. TECHNICAL ASSISTANCE NEEDED.

The Office of Asset Management is responsible for answering programmatic questions for the programs being audited using the procedures outlined in this chapter. Programmatic questions on audits performed using this chapter should be referred to that office, (202) 402-3730.

REAC is responsible for the Financial Assessment Subsystem (FASS). Questions regarding that system are to be referred to REAC's technical assistance center, (888) 245-4860.

3-3. REPORTING REQUIREMENTS. The regulatory agreement for the project requires the owner to submit audited financial statements, prepared in accordance with the requirements of the Secretary, within 90 days after the end of the fiscal year. Although most regulatory agreements may indicate a required submission date of 60 days after the end of the fiscal year, 24 CFR [*Code of Federal Regulations*] 5.801, Uniform Financial Reporting Standards (UFRS), supersedes this requirement by giving projects 90 days to submit their financial statements*. In addition to issuing an opinion, the basic financial statements, and supplemental (supporting) data, the auditor is required to issue, at a minimum, a report on the internal control structure and a report on compliance. The owner must certify to the completeness and accuracy of the financial statements. The management agent, if applicable, must certify to the management of the project.

6

7&8

The owner and management agent certifications are to be made in accordance with the requirements of HUD Handbook 4370.2, paragraphs 3-7 and 3-8. When circumstances prohibit the specified number of partners' or officers' certifying signatures, explanatory information should be provided with the audit report.

The auditor's role is to conduct and report the results of the audit in accordance with auditing standards generally accepted in the United States of America (GAAS) as issued by the American Institute of Certified Public Accountants (AICPA) and the standards applicable to financial audits contained in the generally accepted government auditing standards (GAGAS) issued by the Comptroller General of the United States. It is the owner's responsibility to file an accurate electronic submission with the Real Estate Assessment Center (REAC). In that regard, the independent auditor shall:

A. Issue an independent auditor's report (refer to chapter 2, example A) on the ownership entity's basic financial statements. This report should cover the following items:

9

- Balance sheet.
- *Statement of profit and loss.*
- Statement of changes in partner's capital.[1]
- Statement of cash flows.
- Footnotes to the basic financial statements, including descriptions of accounting policies.

B. Issue an independent auditor's report (refer to chapter 2, example A) on the supplemental information. A paragraph may be added to the auditor's report on the basic financial statements, or a full report may be issued separately.[2] Supplemental information includes the REAC financial data templates, which essentially include support and detail for specific accounts included in the basic financial statement data and certain other information as required by HUD Handbook 4370.2, chapter 3, and as further described in REAC's *Guidelines on Reporting and Attestation Requirements of Uniform Financial Reporting Standards* (UFRS) located on REAC's Web site. The Web address is

http://www.hud.gov/offices/reac/products/fass/mf_doc.cfm.

Use of the guidelines is mandatory for all engagements covered under UFRS.
The financial data templates are further defined in the appendixes of the *Industry User Guide for Financial Assessment Subsystem – Multifamily Housing* (FASSUB). The Industry User Guide is available at the following Web address: http://www.hud.gov/offices/reac/products/fass/fassmf_guide.cfm.

C. Issue any additional reports described in chapter 2.

10

See Example Financial Statements.

[1] Or similarly titled report based on the type of participating ownership entity. For example, if a limited liability company owns the property, "statement of changes in members' equity" should be discussed.
[2] Refer to *AICPA Professional Standards, Volume 1, U.S. Auditing Standards*, AU §551.06e.

3-8. AUDIT FINDING REPORTING. All instances of conditions contained in Appendix B, material noncompliance with any HUD requirement or regulations which result in material questioned or disallowed cost and/or, deficiencies in internal control, instances of fraud or illegal acts, or contract violations that were disclosed during the audit process must be reported as findings in the audit report. All nonmaterial instances of noncompliance disclosed during the audit process must be reported separately to management. Such reporting must be in writing in a management letter or other type of written communication, and form and date of written communication must be mentioned in the independent auditor's report.

11

Noncompliance, deficiencies, or violations that were corrected before the issuance of the audit report must be included in the report as resolved findings or in a management letter or other written communication depending on their materiality.

12

A. Content of Finding.

Findings are to be presented in accordance with the standards and requirements of GAGAS. Refer to chapter 2 for further information on the information that is to be included in a finding.

2011 Yellowbook on Findings

4.10 *In a financial audit, findings may involve deficiencies in internal control; noncompliance with provisions of laws, regulations, contracts, or grant agreements; fraud; or abuse. As part of a GAGAS audit, when auditors identify findings, auditors should plan and perform procedures to develop the elements of the findings that are relevant and necessary to achieve the audit objectives. The elements of a finding are discussed in paragraphs 4.11 through 4.14 below.*

4.11 *Criteria: The laws, regulations, contracts, grant agreements, standards, measures, expected performance, defined business practices, and benchmarks against which performance is compared or evaluated. Criteria identify the required or desired state or expectation with respect to the program or operation. Criteria provide a context for evaluating evidence and understanding the findings.*

4.12 *Condition: Condition is a situation that exists. The condition is determined and documented during the audit.*

4.13 *Cause: The cause identifies the reason or explanation for the condition or the factor or factors responsible for the difference between the situation that exists (condition) and the required or desired state (criteria), which may also serve as a basis for recommendations for corrective actions. Common factors include poorly designed policies, procedures, or criteria; inconsistent, incomplete, or incorrect implementation; or factors beyond the control of program management. Auditors may assess whether the evidence provides a reasonable and convincing argument for why the stated cause is the key factor or factors contributing to the difference between the condition and the criteria.*

4.14 *Effect or potential effect: The effect is a clear, logical link to establish the impact or potential impact of the difference between the situation that exists (condition) and the required or desired state (criteria). The effect or potential effect identifies the outcomes or consequences of the condition. When the audit objectives include identifying the actual or potential consequences of a condition that varies (either positively or negatively) from the criteria identified in the audit, "effect" is a measure of those consequences. Effect or potential effect may be used to demonstrate the need for corrective action in response to identified problems or relevant risks.*

4.28 *When performing a GAGAS financial audit and presenting findings such as deficiencies in internal control, fraud, noncompliance with provisions of laws, regulations, contracts, or grant agreements, or abuse, auditors should develop the elements of the findings to the extent necessary, including findings related to deficiencies from the previous year that have not been remediated. Clearly developed findings, as discussed in paragraphs 4.10 through 4.14, assist management or oversight officials of the audited entity in understanding the need for taking corrective action, and assist auditors in making recommendations for corrective action. If auditors sufficiently develop the elements of a finding, they may provide recommendations for corrective action.*

4.29 *Auditors should place their findings in perspective by describing the nature and extent of the issues being reported and the extent of the work performed that resulted in the finding. To give the reader a basis for judging the prevalence and consequences of these findings, auditors should, as appropriate, relate the instances identified to the population or the number of cases examined and quantify the results in terms of dollar value or other measures. If the results cannot be projected, auditors should limit their conclusions appropriately.*

HUD AUDIT GUIDE CHAPTER 2 ON FINDINGS

.

Content of Finding. Each finding must include all of the following information as appropriate:[3]

a. Numbering the Findings. Each finding is to be numbered using the year followed by a consecutive number (201X-1, 201X-2, 201X-3, etc.).

b. Questioned Costs. Each finding must identify known questioned costs of items resulting from errors or noncompliance that are quantifiable. Identification of these costs should not be limited to only those costs that potentially are to be repaid. If costs are not quantifiable or are unknown, the auditor should so state and indicate the reasons for that determination.

[3] All elements may not be relevant for findings that are internal control deficiencies only.

c. Information on Universe and Population Size. Each finding must include the description and size of the universe and population and information to provide a proper perspective for judging the prevalence and consequences of the audit

findings (for example, whether the audit findings represent an isolated instance or a systemic problem). When appropriate, the instances identified should be related to the universe and the number of cases examined and quantified in terms of dollar value.

d. Sample Size Information. If the error was discovered as a result of a sampling procedure, the size and dollar amount of the sample selected and tested must be included.

e. Noncompliance Information. The number of instances of noncompliance in the sample and the dollar amount of the noncompliance must be included.

f. Condition.[4] The condition is the situation that exists. It is determined and documented during the audit.

g. Criteria. Criteria are the laws, regulations, contracts, grant agreements, standards, measures, expected performance, defined business practices, and benchmarks against which performance is compared or evaluated. Criteria identify the required or desired state or expectation with respect to the program or operation. Criteria provide a context for evaluating evidence and understanding the findings.

h. Cause. The cause identifies the reason or explanation for the condition or the factor or factors responsible for the difference between the situation that exists (condition) and the required or desired state (criteria), which may also serve as a basis for recommendations for corrective action(s). Common factors include poorly designed policies, procedures, or criteria; inconsistent, incomplete, or incorrect implementation; or factors beyond the control of program management. Auditors may assess whether the evidence provides a reasonable and convincing argument for why the stated cause is the key factor or factors contributing to the difference between the condition and the criteria.

i. Effect or Potential Effect. The effect is a clear, logical link to establish the impact or potential impact of the difference between the situation that exists (condition) and the required or desired state (criteria). The effect or potential effect identifies the outcomes or consequences of the condition. When the audit objectives include identifying the actual or potential consequences of a condition that varies (either positively or negatively) from the criteria identified in the audit, "effect" is a measure of those consequences. Effect or potential effect may be used to demonstrate the need for corrective action in response to identified problems or relevant risks.

4 The definitions of condition, criteria, cause, and effect or potential effect are taken from the December 2011 revision of the Yellow Book. Additional information on the content of a finding is set forth in the Yellow Book and can be obtained at the GAO Web site (http://www.gao.gov).

j. Recommendations. Recommendations are the auditor's written suggestions for specific auditee action to correct a deficient condition, prevent recurrence of the

condition, or alleviate the adverse effects of a condition. Each recommendation for each finding is to be consecutively lettered (a, b, c, etc.) and prefixed with the finding number. For example, two recommendations to finding 1 would be 201X-1-a, 201X-1-b, and two recommendations to finding 2 would be 201X-2-a, 201X-2-b.

1. Corrective Actions Not Started or in Process.
Finding 201X-1.

Each finding is to be listed and must contain the required information contained in paragraph 2- 4.D.4, Content of Finding. The numbering of the findings and recommendations related to each finding is to follow the requirements in paragraphs 2-4.D.4.a and j.

Recommendations:
201X-1-a.
201X-1-b.
Management comments:

2. Corrective Action Completed.
Finding 201X-2.

Each finding is to be listed and contain the required information contained in paragraph 2-4.D.4, Content of Finding. The numbering of the findings and recommendations related to each finding is to follow the requirements in paragraphs 2-4.D.4.a and j.

Recommendations:
201X-2-a.
201X-2-b.
Management comments:

k. Reporting Views of Responsible Officials. Auditors should obtain and report the views of responsible officials concerning the findings, conclusions, and recommendations, which should include the auditee's planned corrective action(s). GAGAS provide additional guidance on this finding element. This element of a finding reported in the schedule of findings, questioned costs, and recommendations is different from the separate corrective action plan the auditee is required to prepare, which is described further in paragraph 2-4.G.

E. Management Letter. Certain chapters in this audit guide require the auditor to communicate all nonmaterial noncompliance to management in writing. A management letter or other type of written auditor communication to management may be used to report such noncompliance. If auditors issued or intend to issue a management letter (or other similar written communication) for this purpose, their report is to refer to that communication by name and the actual or planned date of issuance. Note that a management letter should not be used to report material findings that were resolved before the audit report was issued. Such findings are to be reported

as findings in the auditor's report (by reference to finding numbers) and on the schedule of findings, questioned costs, and recommendations under the category "Corrective Actions Completed."

F. Schedule of the Status of Prior Audit Findings, Questioned Costs, and Recommendations. This schedule is to be prepared by the auditee and is to be included in the audit report package. This schedule must be prepared by the auditee in connection with the audit for the year following the year that an audit report package was issued with audit findings. The schedule should address all findings that were in the prior year report, including whether any questioned costs were paid or otherwise resolved by HUD. A description of the prior audit finding, along with the current status, should be included for each finding. If a finding is no longer relevant, the schedule should note the reason(s). See example E in paragraph 2-6 for an illustrative schedule of the status of prior audit findings.

The auditor should inquire about any audits, attestations, studies, or reviews conducted by HUD OIG, HUD management, a contract administrator, or any other Federal agency that directly relate to the current year audit of the entity's financial statements. Any findings from such reviews should also be included by the auditee in this schedule even if corrective action has already occurred. A description of the prior audit finding, along with the current status, should be included for each finding. The auditor may rely on management's representation as to reports issued during the audit period. The auditor does not have to independently confirm the completeness of all reports listed by the auditee with outside sources.

The auditor should follow up on prior audit findings reported by the auditee, perform procedures to assess the reasonableness of the schedule, and report as a current year finding when the auditor concludes that the schedule materially misrepresents the status of any prior audit finding. If uncorrected, the finding should be repeated as a current finding and so stated on the schedule of the status of prior audit findings with the finding referenced to the current finding number.

G. Corrective Action Plan. A corrective action plan (CAP) is to be prepared by the auditee, and it should be transmitted to HUD as a separate part of the audit report package. The CAP is to be a separate and distinct document from the views of responsible officials included with each finding in the schedule of findings, questioned costs, and recommendations. Using the format in example F, paragraph 2-6, the auditee official is to describe the corrective action(s) taken or planned in response to the current year finding(s) identified by the auditor. It should include task(s), subtask(s), and date(s) for the completion of the action. If funds need to be returned to the program from non-Federal sources, the plan should include information on the method of reimbursement, source of funds, and repayment schedule.

When the schedule of the status of prior audit findings identifies prior findings as unresolved or "open," the CAP should include comments on the corrective action taken and the action that will be taken on the open prior findings (see example E, paragraph 2-6, for an illustrative schedule of the status of prior audit findings).

The auditee is to express its agreement or disagreement with the content of the finding, and if the auditee disagrees with the finding, it is to fully explain the points of that disagreement with specific information to support its position. If the information is voluminous, an appendix may be attached to the audit report package.

Also, the auditee is to express its agreement or disagreement with each recommendation. If there is disagreement with the recommended course of action, the auditee should explain the points of that disagreement and propose an alternative action that would accomplish the same goal.

In addition to the above CAP requirements related to reported findings, the Office of Lender Activities requires the submission of a CAP as a separate part of the audit report package for all issues included in a management letter when such a letter is issued for audits that are performed under chapter 7 of this audit guide.

B. Corrective Action Not Started or in Process.

When the project's management has not started to correct the findings or is in the process of correcting a finding at the time of report issuance, the auditee can include a description of the action completed and the action remaining to be taken in the auditee's response to the finding, stated in the auditee's comment section of the finding and in the corrective action plan.

C. Corrective Action Completed.

When the project's management has corrected a finding, the action taken should be included in the auditee's response to the finding, stated in the auditee's comment section of the finding and in the corrective action plan, and should be validated by the auditor. The auditor's recommendation in the finding should state the results of the auditor's validation testing. In addition, the auditor could include any additional recommendations that he/she believes are necessary based on the auditor's validation of that action.

D. Reporting When Using the Group Project-Based Sample Method.

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When a condition or weakness is found in one of the projects in the sample, during the audit testing, that is required to be reported in a finding, it must be reported in the audit report for each project in the population from which the sample was drawn. Reference should be made to each report that contains that type finding. If dollars are involved, only the dollars belonging to that specific project should be included in that project's audit finding. For example, the following illustrates wording that can be used: "This internal control problem applies to and is reported in 15 audit reports, 5 for projects owned by companies related to the X Housing Cooperation and 10 projects owned by two unrelated owners. The total disallowed cost is $450,000, of which $100,000 applies to this project, and $200,000 applies to the other 4 projects owned by companies related

to the X Housing Cooperation and $150,000 applies to the 10 projects owned by the two unrelated owners."

If the condition is only to be reported in the management letter or other written communication, it must be communicated similarly in all projects of the population from which the sample was drawn.

AHACPA Note – Obviously, this statement requires the auditor to determine the dollar value of the error for each project included in the sample. Projects not included in the sample, but subject to the reporting requirement may also need to be evaluated to determine the potential materiality of the error of those financial statements.

3-4. SAMPLE SELECTION. According to the Government Auditing Standards, published by the Government Accountability Office (GAO), the third fieldwork standard for financial audits states: The auditor must obtain sufficient appropriate audit evidence by performing audit procedures to afford a reasonable basis for an opinion regarding the financial statements under audit.

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Audit sampling, when properly applied, can provide sufficient appropriate evidence to support the audit opinion.

Audit sampling is defined as the application of an audit procedure to less than 100 percent of the items within an account balance or class of transactions for the purpose of evaluating some characteristic of the balance or class. There are two general approaches to audit sampling: nonstatistical and statistical. Both approaches require the auditor to use professional judgment in planning, performing, and evaluating a sample and in relating the audit evidence produced by the sample to other audit evidence when forming a conclusion about the related account balance or class of transactions.

It is important that the sample selected be representative of the population. The size of a sample necessary to provide sufficient audit evidence depends on both the objectives and the efficiency of the sample. Because of the previous inconsistency in the application of the sampling process in auditing HUD programs, OIG convened a panel consisting of representatives from OIG, HUD REAC, AICPA, and several auditing firms with significant HUD experience to discuss the issue and potential solutions. Based on the feedback from that panel, OIG decided and all participants agreed that attribute sampling[3] is the appropriate sampling methodology for use in auditing programs using this chapter to provide consistency and to assure adequate coverage to support the audit opinions rendered.

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The attribute sampling method of selecting a sample is to be used anytime in this chapter a statement is made that a sample is to be selected. If the auditor is of

[3] **Until such time as OIG decides to extend this approach to other chapters, attribute sampling will only apply to audits performed using chapter 3.**

the opinion that another sampling method should be used for a particular audit; for example, when the objective is to sample transaction dollar values for purposes of statistically estimating over/understatements (variable sampling methodology), the working papers must contain justification for the methodology used. Appendix A to this chapter provides additional information on attribute sampling. The sample sizes stated in appendix A are to be the minimum sample sizes to be used regardless of the methodology the auditor uses in lieu of attribute sampling.

Insert from SAS 39

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The third standard of field work requires the auditor to obtain sufficient competent evidential matter that is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit.

Examining the documentation for every transaction of a business is expensive and time-consuming. Since most audit objectives do not require that amount of evidence, auditors frequently use sampling techniques and procedures.

Statement on Auditing Standards ("SAS 39") was issued to provide guidance on the design and selection of an audit sample and the evaluation of the sample results. SAS 39 applies equally to both statistical and non-statistical sampling methods by concluding that either approach can provide sufficient evidential matter as provided by the third standard of field work.

When using either statistical or non-statistical sampling methods, auditors should design and select an audit sample, perform audit procedures thereon and evaluate sample results so as to provide sufficient appropriate audit evidence.

Types of Sampling

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Attribute sampling measures the frequency of a specific occurrence in a particular population. This sampling technique is used to discover how often exceptions occur in the population under examination. Thus, attribute sampling is concerned with the qualitative characteristics of a sample. Generally, attribute sampling is associated with tests of controls, the results of which are the basis for assessing control risk at a level less than the maximum level.

Audit Objectives:

Auditors first consider the specific audit objectives to be achieved and the audit procedures which are likely to best achieve those objectives. In addition, when audit sampling is appropriate, consideration of the nature of the audit evidence sought and possible error conditions or other characteristics relating to that audit evidence assists auditors in defining what constitutes an error and what population to use for sampling. For example, when performing tests of control over an entity's purchasing procedures, auditors are concerned with matters such as whether an invoice was clerically checked and properly approved. On the other hand, when performing substantive procedures on invoices processed during the period, auditors are concerned with matters such as the proper reflection of the monetary amounts of such invoices in the financial statements.

Population:
The population is the entire set of data form which auditors wish to sample in order to reach a conclusion. The population selected for examination must be complete and must provide the auditor with the opportunity to satisfy the established audit objective.

Stratification:
To assist in the efficient and effective design of the sample, stratification may be appropriate. Stratification is the process of dividing a population into sub-populations, each of which is a group of sampling units, which have similar characteristics. The similar characteristic is usually the monetary value. The strata need to be explicitly defined so that each sampling unit can

belong to only one stratum. This process reduces the variability of the items within each stratum. Stratification enables auditors to direct audit efforts towards the items which, for example, contain the greatest potential monetary error. For example, auditors may direct attention to larger value items for debtors to detect over stated material misstatements. Consequently, stratification may result in a smaller sample size.

Tolerable Error:
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Tolerable error is the maximum error in the population that auditors would be willing to accept and still concludes that the result from the sample has achieved the audit objective. Tolerable error is considered during the planning stage and, for substantive procedures, is related to the auditors' judgment about materiality. The smaller the tolerable error, the greater the sample size needs to be.

In tests of control, the tolerable error is the maximum rate of deviation from a prescribed control procedure that auditors would be willing to accept and still concludes that the preliminary assessment of control risk is valid. In substantive procedures, the tolerable error is the maximum monetary error in an account balance or a class of transaction that auditors would be willing to accept so that when the results of all audit procedures are considered, auditors are able to conclude, with reasonable assurance, that the financial statements are not materially misstated.

Expected Error:
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If auditors expect errors to be present in the population, a larger sample, than when no error is expected, ordinarily needs to be examined to conclude that the actual error in the population is not greater than the planned error. Smaller sample sizes are justified when the population is expected to be error free.

In the decision making process to determine the expected error in a population, auditors would consider such matters as error levels identified in previous audits, changes in the entity's procedures, and evidence available from other procedures, including tests of controls.

Selection of sample size:
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Auditors should select sample items in such a way that a sample can be expected to be representative of the population in respect of characteristics being tested.

For a sample to be representative of the population, all items in the population are required to have an equal or known chance of being selected. SAS 39 requires that a representative sample be selected for both non-statistical and statistical sampling. When statistical sampling is used, the sample must be selected on a random basis.

SAS 39 does not define "representative sample," but there is an implied difference between a representative sample and a random sample. For a selection method to be random, each item in the population must have an equal chance of selection.

While there are a number of selection methods, the three methods commonly used are as follows:

1. ***Random Number Selection:***
This method ensures that all items in the population have an equal chance of selection. A sample may be selected from the population on a random basis using random numbers generated by a computer or numbers chosen from a random number table.

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2. Systematic Selection:

This method involves selecting items using a constant interval between selections, the first interval having a random start. We may select a random sample using the systematic-selection method, whereby every nth item is selected. The following steps should be followed when systematic selection is used:

1. Determine the population (N)
2. Determine the sample size (n)
3. Compute the interval size by dividing N by n
4. Select a random start
5. Determine the sample items selected by successively adding the interval to the random starting point

1. Judgmental Selection:

This may be an acceptable alternative to random selection provided the auditors attempt to draw a representative sample from the entire population with no intention to either include or exclude specific units. Under this method, care should be taken to guard against making a selection that is biased, for example, towards items which are easily located, as they may not be representative.

EVALUATION OF SAMPLE RESULTS

Having carried out, on each sample item, those audit procedures that are appropriate to the particular audit objective, auditors should:

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Analyze any errors detected in the sample; and Draw inferences for the population as a whole.

Analysis of errors in the sample:

Before analyzing the errors detected in the sample, auditors first need to determine that an item in question is in fact an error. In designing the sample, we need to define those conditions that constitute an error by reference to the audit objectives. For example, in a substantive procedure relating to the recording of tenant accounts receivable, a mis-posting between the tenant accounts receivables does not affect the total tenant accounts receivable. Therefore, it may be inappropriate to consider this error in evaluating the sample results of this particular procedure, even though it may have an effect on other areas of the audit such as the assessment of the allowance for doubtful accounts.

Inferences to be drawn for the population as a whole:

- *Projection of errors and re-assessing sampling risk*

- *Auditors then would project the error results of the sample to the population from which the sample was selected in order to form a conclusion about the possible level of error in the population as a whole. This process of projection of the error results of the sample to the population as a whole involves estimating probable error in the population by extrapolating the errors noted in the sample. When projecting error results, auditors would ensure that the method of projection is consistent with the method used to select the sampling unit. This is done in addition to considering the qualitative aspects of the errors noted. When the population has been divided into sub-populations, the projection of errors is done separately for each sub-population and the results are combined.*

- *The next step is to consider whether the errors in the population might exceed the tolerable error. In this process, auditors need to compare the projected population error to the tolerable error taking into account the results of other audit procedures relevant to the specific control or financial statement assertion.*

When the projected error exceeds the tolerable error, auditors re-assess the sampling risk and if that risk is unacceptable, consider extending the audit procedure or performing alternative audit procedures, either of which may result in them proposing an adjustment to the financial statements

Suggested Steps to Apply Attribute Sampling To Tests Of Controls

- *Frequency of a specific occurrence in a particular population is measured by attribute sampling. Attribute sampling technique is used to discover how often exceptions occur in the population under examination. As such attribute sampling is concerned with the qualitative characteristics of a sample-with tests of controls, which the auditor must perform in order to assess control risk at less than maximum.*

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The following steps are suggested to apply attribute sampling to tests of controls:

Determine the objectives of the test:

- *The objective must be defined in terms of specific compliance characteristics that can be tested.*
- *When testing controls, the auditor must determine whether the control objective is being achieved.*
- *Every control objective must have one or more stated control techniques, which are designed to achieve the control objectives.*
- *Controls may be classified as preventive or detective. Preventive controls are established to prevent errors form occurring. Detective controls are established to detect errors that have occurred.*

Define the deviation conditions

- *A deviation is a departure form a prescribed internal control procedure.*
- *There is a deviation condition when a necessary step to achieve a control objective is not performed.*
- *The auditor must identify any significant deviation conditions that exist in the control process.*

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Define the population - *The population identified for examination must be complete and must provide the opportunity to satisfy the predetermined audit objectives.*

Define the period covered by the test - *The population from which the sample is selected should include all transactions for the accounting period under examination.*

Consider the completeness of the population - *The defined population under examination must be complete; otherwise, a representative sample cannot be drawn form the sample.*

Define the sampling unit - *The population may consist of a number of sampling units, like purchase invoices or cancelled checks. The auditor should define the sampling unit.*

Determine the method of selecting the sample - *SAS 39 requires that a representative sample be selected for both statistical and non statistical sampling. It should be noted that when statistical sampling is used, the sample must be selected on a random basis.*

Determine the sample size - *Determining the appropriate sample size is a matter of professional judgment. In statistical sampling the factors that are used to determine the sample size are quantified, whereas in non statistical sampling the factors will be described in subjective terms.*

Consider the allowable risk of assessing control risk too low

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- *The level of sampling risk is influenced by the size of the sample.*
- *Achieving an acceptable level of sampling risk is the result of a trade-off between trying to avoid over auditing on one hand and under auditing on the other.*
- *Establishing an allowable risk of assessing control risk too low is a function of the degree of assurance indicated by the evidential matter selected as a part of the sample process.*
- *Establishing a small risk of assessing control risk too low will require an increase in the sample size.*
- *Thus, the larger the sample size, the higher the degree of assurance an auditor can offer about the effectiveness of internal control.*

Consider the tolerable rate

- *According to SAS 39 the establishment of tolerable rate in an engagement is based on (a) the planned assessed level of control risk and (b) the degree of assurance indicated by the evidential matter in the sample.*
- *The tolerable rate is the maximum percentage of deviations in a population that an auditor will tolerate without changing the planned assessed level of control risk.*
- *The planned level of control risk is established after obtaining an understanding of the client's internal control system. This is a factor in determining the sample size for tests of control. If an internal control component is considered highly relevant to a critical financial statement assertion, the auditor would initially plan to rely heavily on the control procedure and more likely establish a small tolerable error.*

Consider the population deviation rate

- *The expected population deviation rate is the anticipated deviation rate in the entire population. The anticipated deviation rate in the population should be estimated based upon the results of prior audits, taking into consideration any subsequent modifications of the client's internal control.*
- *If the expected population deviation rate approached the tolerable rate that the auditor established, the required sample size increases because an allowance should be made for sampling risk.*

Sample size and non-statistical sampling

- *When using non-statistical sampling, consideration should be given to the Risk of assessing control risk too low, the tolerable rate, the expected population deviation rate to determine the sample size. When using non-statistical sampling we should use the following generalizations in determining the sample size.*
- *As the risk of assessing control risk too low increases, the required sample size decreases.*
- *As the risk of control risk too low decreases, the required sample size increases.*
- *As the tolerable rate increases, the required sample size decreases.*
- *As the tolerable rate decreases, the required sample size increases.*
- *As the expected population deviation rate increases, the required sample size increases.*
- *As the expected population rate decreases, the required sample size decreases.*

Apply audit procedures - *Audit procedures should be applied to each sampling unit to determine if there has been a deviation from the established internal control procedure.*

Evaluate the sample results - *After applying audit procedures to each sampling unit, summarize the deviations, if any, from the prescribed internal controls and evaluate the results of sampling.*

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Calculate the deviation rate -*The sample deviation rate is the auditor's best estimate of the population deviation rate. This is computed by dividing the number of deviations by the number of units in the sample.*

Consider the sampling risk - *Next, consider the degree of sampling risk involved in the sample results. This needs to be done as the auditor does not examine the entire population. As we have discussed earlier, an entirely different conclusion can be reached on the basis of sample results than if the entire population is examined. The degree of sampling risk can be determined by computing the maximum population deviation rate.*

Consider the qualitative aspects of the deviations - *The nature and cause of each deviation should be analyzed. Deviations should be classified as intentional errors or unintentional errors. Intentional errors may be acts of fraud. The auditor should consider whether the deviation resulted from a misunderstanding of instructions or from carelessness.*

Reach an overall conclusion - *Auditor's professional judgment is required in reaching a conclusion on how the results of the test of controls will affect the nature, timing, and extent of the substantive tests. We need to evaluate whether the overall audit approach supports the planned assessed level of control risk based upon the Sample results of tests of controls.*

Documentation of sampling procedures - *Sampling procedures should be documented. Audit documentation as required by SAS -96 should be satisfied. General consensus is to at least document in the audit work papers the following:*

- *A brief description of the internal controls tested*
- *Objective of the tests of controls*
- *Definition of the population*
- *Definition of the sample size*
- *Method of determining sample size*
- *Method of sample selection*
- *Definition of deviation conditions*
- *Description of audit procedures*
- *List of deviations noted*
- *Classification of deviations as intentional and unintentional*
- *Strategy when deviations exceed the planned deviation rate*
- *Evaluation of sample results and overall conclusions*

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*Appendix A

Attribute Sampling

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When planning to test a particular sample of transactions, the auditor should consider the specific audit objective to be achieved and should determine whether the audit procedure, or combination of procedures, to be applied will achieve that objective. The size of a sample necessary to provide sufficient evidential matter depends on both the objectives and the efficiency of the sample. As noted in section 3-8 of this chapter, all material instances of noncompliance, including those identified through sampling, must be reported as findings in the audit report.

Determining Test Objective, Defining the Population, and Defining an Exception.

Before beginning testing, the auditor must understand and document what attribute and/or assertions are being tested. The auditor needs to identify and document the appropriate population and should also perform procedures (e.g., reconciliations, inquiry) to ensure that the population from which the samples are selected is complete.

Each compliance requirement selected for testing should be considered a separate population, and samples should be selected accordingly. The sample selected could possibly be used to test multiple attributes within each compliance requirement. Additionally, auditors must assess the control environment at entities with multiple locations. If controls at the different locations are significantly different, each location must be considered a separate population.

AHACPA Note – Once again, there is no guidance defining "significantly different". The auditor will have to use professional judgment in applying this rule.

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The auditor must document the "sampling unit," which is the individual item subject to sampling in the population (i.e., reconciliations, loan files, cash disbursements, cash receipts, etc.).

When selecting the sample of individual items, auditors must ensure that the sample is representative of the universe for the compliance requirement being tested.
The auditor should also clearly define what would be considered an exception. A single exception would indicate noncompliance, subject to further determination of materiality necessary to determine the required method of reporting.

Determining the Sample Size. To determine attribute testing sample sizes, the auditor needs to determine the value for three inputs: desired confidence level, tolerable exception rate, and expected exception rate.

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Desired Confidence. Auditors should obtain a high degree of assurance by using a confidence level of 90, 95, or 99 percent.

By definition, the desired confidence is the degree of assurance desired by the audit evidence in the sample.

Tolerable Exception Rate. A 5-10 percent exception rate is acceptable.

The tolerable rate is the maximum rate of deviations from the prescribed control that the auditor would be willing to accept without altering his planned assessed level of control risk..

Expected Exception Rate. No exceptions should be accepted.

Materiality. Using attribute testing, monetary materiality or tolerable misstatement is not a necessary input for determining sample size.

Sample Size Table. Using the preferences above and an attribute sampling software program, if a high level of assurance is defined as 90 percent confidence and tolerable exception rate is 5 or 10 percent with an expectation of zero exceptions, the sample size is 48 or 23 (respectively for 5 and 10 percent exception rates), which is rounded to 50 and 25 below. Similarly, using 95 percent confidence, zero exceptions, and a 5 or 10 percent tolerable exception rate, the sample size is 64 or 32, which is rounded to 65 and 35 below.

Compliance sample size table

Importance/significance of the attribute being tested	Confidence level	Tolerable rate	Minimum sample size for populations over 200
Low	90%	5%	50
Low	90%	10%	25
High	95%	5%	65
High	95%	10%	35

This table is illustrative but does not replace professional judgment. As noted in the table, these are minimum sample sizes, and there may be many situations in which the auditor should also consider qualitative factors when determining sample size.

AHACPA Note – As shown in the above table, the extent of the auditors testing will depend entirely on the risk assessment performed to determine the significance of the attribute to be tested. This may include such factors as major/nonmajor program, potential for significant error or HUD's determination of the significance of the item to be tested. For instance, surplus cash will have a much higher degree of significance than property additions in most circumstances.

Such qualitative factors may include but are not limited to

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(1). First year the auditor audited an entity.
(2). Larger, decentralized entities.
(3). High number of findings in the past.
(4). Significant deficiencies or material weaknesses in the past.*
(5). *Poor internal controls.
(6). Extremely high volume of activity in a particular compliance requirement.
(7). High project employee turnover in a particular area or department.

If the initial sample does not include a particular attribute being tested, then typically there would be a need to have additional items included in the sample to address just that specific attribute.

Each compliance test performed should be evaluated separately for purposes of determining sample size. Judgment should be used to determine what tests are considered low risk and which are considered high risk. When making the determination of high or low risk, it will be important to understand the population.

AHACPA Note – This requirement precludes the one sample to achieve multiple compliance tests. For instance, previously the auditor may have selected a sample of tenant files to test Section 8 procedures. The auditor could have added additional steps to the test to trace cash receipts back to the bank account and general ledger. That is now no longer acceptable.

Populations of 200 or Fewer Items.

When performing compliance testing of populations of fewer than 200 items, the following guidance is provided. Generally examine at least

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(1). 20 items when the population being tested contains between 100 and 199 items,
(2). 10 items when the population being tested contains between 50 and 99 items,
(3). Five items when the population being tested contains between 20 and 49 items, and
(4). Fewer than five items for smaller populations

As noted above, these are suggested minimum sample sizes, and there may be quantitative factors used to determine the sample size to be used.

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Testing and Evaluating Results.

The sample sizes in the table above are based on an expectation of no exceptions. If the testing performed discovers no exceptions, then the auditor has achieved a high degree of confidence that the attribute/assertion is performed at an acceptable level.

If there are observed exceptions, the auditor should investigate the nature and cause of the exceptions to determine whether the exceptions are immaterial or material compliance findings, significant deficiencies, or material weaknesses in internal control. It is not necessary to expand testing when exceptions are found. All exceptions must be reported. Refer to paragraph 3-8 for reporting requirements using this audit guide.

In cases in which an exception is found, the auditor must determine whether the individual exception is material enough to be included in the report. If it is determined that an exception is not material enough to be reported as a finding, the auditor may want to apply additional procedures to evaluate the magnitude of the exception.

The auditor should consider whether the lack of an effective internal control constitutes a significant deficiency or a material weakness and document the basis for an unqualified opinion if a finding is determined to be a significant deficiency or material weakness.

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Work Paper Documentation Needed.

Documentation of sampling procedures must include the test objective, definition of an exception, description of the population tested and the sampling unit, confidence level, significance of the attribute, sample size, and the results of testing.

Technical Assistance Available.

Technical guidance on audit sampling is available in the following documents:

- SAS No. 39. *Audit Sampling* (AICPA)
- SAS No 111. Amendment to SAS No. 39, Audit Sampling (AICPA, *Professional Standards,* vol. 1, AU sec. 350), as amended
- AICPA Audit Guide. *Audit Sampling,* New Edition as of April 1, 2001
- AICPA Audit Guide. *Government Auditing Standards*
- SAS No. 74. *Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance* (AICPA, *Professional Standards, vol. 1, AU sec. 801)*

3-5. COMPLIANCE REQUIREMENTS AND AUDIT AREAS. The following sections contain suggested audit procedures that HUD believes should be performed. If an auditor determines that the stated procedures to be inappropriate and/or other audit procedures should be performed, the deviation from the stated procedures must be justified and documented in the auditor's working papers.*

34-35

A. FEDERAL FINANCIAL REPORTS.

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1. Compliance Requirement. Projects are required to ensure that financial status reports contain reliable financial data and are presented in accordance with the terms of applicable agreements between the project and HUD. The individual agreements contain the specific reporting requirements that the project must follow. *HUD will usually require monthly reports whenever annual financial reviews, on-site reviews, or other information indicates that the project is experiencing financial or management difficulties or the owner/agent is suspected of noncompliance (HUD Handbook 4370.1, chapter 3). The type of annual statements can vary by program. HUD Handbooks 4370.2 and 4350.1 provide detailed guidance as to which owners must submit financial statements and the types of statements that are required.

AHACPA Comment – The following is from HUD Handbook 4370.2 2-15.A. In a Section 236 project, the total of all excess rents collected from units charged in excess of the basic monthly rent shall be remitted monthly to:

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

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Forms HUD-93104, Monthly Report of Excess Income and Accrued Unpaid Excess Income and HUD-93104A, Schedule for Calculating Excess Income and Report of Excess Income Delinquencies, are included in Appendix 3 and are to be used for this purpose.

4370.2 3-2. B. The Regulatory Agreement also contains an option to require monthly occupancy reports: "At the request of the Secretary , his agents, employees, or attorneys, the owners shall furnish monthly occupancy reports and shall give specific answers to questions upon which information is desired from time to time relative to the revenue, assets, liabilities, contracts, operation, and condition of the property and the status of the insured mortgage."

4370.1 - CHAPTER 3. MONTHLY ACCOUNTING REPORTS

SECTION 1. Managing Monthly Accounting Review Process

3-1. INTRODUCTION
Monthly accounting reports are useful tools for evaluating a project's performance and monitoring compliance. The Asset/Loan Management Branch Chief must ensure that the Asset/Loan Management staff fully uses each accounting report. This means:
Requiring the submission of monthly reports, when appropriate (monthly statements are generally required whenever annual financial

statement reviews, on-site management reviews or other information indicates that the project is experiencing financial or management difficulties or the owner/agent is suspected of noncompliance)

- *Following-up with the owner/management agent to obtain receipt of monthly reports*
- *Ensuring that monthly reports are reviewed by the Asset/Loan Management staff in a timely and quality manner*
- *Following-up to make sure that recommended actions are taken, and*
- *Terminating the submission of monthly reports, (whenever continuous review of monthly and annual reports indicates that the project owner/management agent has taken necessary corrective action(s) and the project is no longer experiencing financial or management difficulties).*

SECTION 2. Analyzing Monthly Reports

3-4. INTRODUCTION

This Section provides guidance on how to review monthly accounting reports. Similar to the annual review, the monthly review has three purposes:

- *evaluate compliance,*
- *identify potential diversions, and*
- *assess project performance.*

The review procedures require the Asset/Loan Management staff to review individual transactions and to analyze month-to-month trends in:

- *cash flow,*
- *occupancy,*
- *rent collections, and*
- *liquidity.*

3-5. COOPERATIVE HOUSING REPORTS

The Board of Directors is responsible for submitting the Monthly Report Of Cooperative, Housing Corporations, Form HUD-93211, each month for the first two full fiscal years following the initial date of project operations.

This report provides the means to analyze the actual revenue and expenses versus budgeted amounts to determine financial trends or areas of concern, and to accumulate information for the preparation of the ensuing year's budget. See Handbook 4370.3, "Uniform System of Accounts for Cooperative Housing Corporations Using Computer and Manual Systems" for a more detail discussion of Form HUD-93211.

3-6. CHECK FOR COMPLETION

Upon receipt of the monthly reports, the Asset/Loan Management staff should check to see if:

A. Each of the following schedules has been submitted:

1. Schedule A - HUD-93479, Monthly Report for Establishing, Net Income
2. Schedule B - HUD-93480, Schedule of Disbursements
3. Schedule C - HUD-93481, Schedule of Accounts Payable

B. All lines have been completed for each schedule. If a schedule is missing or is incomplete, the Asset/Loan Management staff should immediately request any missing or corrected schedules from the owner/management agent. Copies of the above schedules are included in Appendices 15A, B and C.

4350.1 10-11. MONTHLY ACCOUNTING REPORTS. Upon receipt of a notice of election to assign a mortgage, Monthly Accounting Reports, Forms HUD-93479, 93480, and 93481, including project net cash, must be submitted by the project owner. These reports will assist in determining the owner's compliance with HUD requirements and the terms of any workout arrangement requested, identifying diversions of project assets and assessing owner's performance. The monthly accounting reports should be analyzed upon receipt by the Loan Management Branch staff. Detailed procedures for review and analysis of monthly accounting reports are contained in HUD Handbook 4370.1. Loan Management/Asset Management staff should also review the Statement of Multifamily Mortgage Account & Notice of Mortgage Payment Due (Form HUD 2771) to be sure the owner is submitting the required monthly payments. If the owner is not submitting the required monthly payments or is in violation of any financial commitment, the Loan Servicer/Asset Manager must contact the project owner and inform him/her of the importance of timely and accurate payments. If the owner fails to respond, the Loan Servicer/Asset Manager and Supervising Loan Servicer or Loan Management Branch Chief must develop a plan of corrective action and contact the owner with the necessary requirements.

2. Suggested Audit Procedures.

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a. Identify all required financial reports by inquiry of the owner/management agent and review of agreements and correspondence with HUD. Request a copy of auditee submissions to HUD during the period under audit.
b. Obtain an understanding of the owner/management agent's procedures for preparing and reviewing the financial reports.
c. Select a sample of financial reports, other than those included in the annual financial statements, and determine whether the reports selected are prepared in accordance with HUD instructions.
d. For the sample selected, determine whether significant data reported are accurate. Report all material differences between financial reports and project records.
e. Determine whether the project complied with HUD's reporting requirements.

B. FAIR HOUSING AND NONDISCRIMINATION.

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1. Compliance Requirement. Owners and management agents are prohibited from discriminatory practices in accepting applications, renting units, and designating units or sections of a project for renting to prohibited bases in accordance with the Fair Housing Act and the provisions of the regulatory agreement.
2. Suggested Audit Procedures.

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a. Obtain a copy of the project's approved affirmative fair housing marketing plan, if applicable. Review the marketing plan for compliance with appropriate statutes

and the regulatory agreement. Section 232 projects will not have an affirmative fair housing marketing plan but have a regulatory obligation not to discriminate.

b. Obtain an understanding of the owner/management agent's policies and procedures relating to marketing of the units; processing, approving, and rejecting applications; and providing reasonable accommodation to applicants and tenants with disabilities in accordance with the requirements of applicable federal civil rights laws *and the Americans with Disabilities Act.*

AHACPA COMMENT

Although the HUD Audit Guide still lists Fair Housing as a required audit step, in 2013, HUD OIG removed the Fair Housing reporting requirement from Chapter 2 of the Guide. The lift auditors with confusion as to what the requirements are. These leaves auditors with three choices in their approach:

1. Continue to perform the testing on Fair Housing and include Fair Housing as a component in the major program report.
2. Do not perform fair housing testing.
3. Perform testing, but report no where.

AHACPA reminds users of the previous restriction in the HUD Audit Guide from reporting on fair housing. The restriction was contained in chapter 1 of the 2001 Guide.

> *When performing tests of compliance requirements contained in Chapter 4, the IA should report on fair housing and nondiscrimination. Where the HUD-assisted activity is nonmajor, fair housing reporting should be included in the auditor's report on non-major HUD-assisted programs. Where the HUD-assisted activity is major, the auditor's report on specific requirements applicable to fair housing should be separate (Example E) from the auditor's opinion on compliance with specific requirements applicable to major programs.*

Accordingly, AHACPA does not believe such testing is necessary given that the reporting restriction on the major program does not allow for an opinion on fair housing. Therefore, such testing would only be required if a Fair Housing violation occurred and could impact the financial statements.

c. Obtain a copy of the project's tenant selection plan as required by HUD Handbook 4350.3. Review the plan for compliance with the handbook and perform the following steps:
(1) Determine whether there are indications of any discriminatory practices such as prohibited screening practices based on
i. Race, color, religion, sex, national origin, age, family status, or disability;*
ii. Segments of population, e.g., welfare recipients, single-parent household;
iii. Income;
iv. Lack of rental history; or
v. Other civil rights and nondiscrimination requirements listed in Handbook 4350.3.
(2) Determine whether the plan is updated every five years.

4350.3 HUD Occupancy Handbook

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C. ***Required Contents of the Tenant Selection Plan***

The tenant selection plan helps to ensure that tenants are selected for occupancy in accordance with HUD requirements and established management policies. HUD requires that the plan specify a number of procedures and policies, including the following items:

1. Project eligibility requirements.

a. Project specific requirements. If the property is designated for a special population, such as elderly or disabled, the owner must define population served.

b. Citizenship/immigration status requirements. The owner must describe how citizenship/immigration requirements are implemented, including policies regarding verification of citizenship (if any).

*c. *Social security number (SSN) requirements. Requirements for disclosing and providing verification of SSNs.**

2. Income limits (including economic mix for Section 8 properties). The income limit schedule used for the property must be identified (i.e., very low- or low-income. The specific maximum annual income amounts need not be included).

3. Procedures for taking applications and selecting from the waiting list.

a. Taking applications. The plan must include policies for taking preapplications (if applicable) and applications.

b. Preferences. The plan must define each preference adopted for use in the property and any rating, ranking, or combining of the preferences the owner has established that will affect the order in which applicants are selected from the waiting list. The plan should also describe the acceptable sources of information to verify the qualification for preferences.

***REMINDER**: Owners implementing state, local, or residency preferences must have prior HUD approval.*

c. Income-targeting. For Section 8 properties only, the plan must describe the procedures used by the owner to meet the income targeting requirements, if applicable. This description must explain how and when applicants will be "skipped over" in favor of housing an extremely low-income household and how their applications will be treated when they are skipped.

*d. Applicant screening criteria. The plan must describe the property's standards used to screen for information on drug related or criminal activity (including registration as a sex offender) *and use of the EIV Existing Tenant Search*, as well as the other screening activities implemented by the owner (e.g., rental history).*

e. Procedures for rejecting ineligible applicants. The plan must describe the circumstances under which the owner may reject an applicant for occupancy or assistance. If the owner establishes a policy to consider extenuating circumstances in cases when applicants would normally be rejected but have circumstances that indicate the family might be an acceptable future tenant, such a policy must also be described in the plan.

4. Occupancy standards. Standards used by the owner to determine appropriate unit size, and procedures to place families on the lists for more than one unit size, must be included in the plan.

5. Unit transfer policies, including procedures for selecting between applicants on the waiting list and current tenants who need:

a. A unit transfer because of family size;

b. A new unit because of changes in family composition;

c. A deeper subsidy (Rent Supplement, RAP, or Section 8 assistance);
d. A unit transfer for a medical reason certified by a doctor; or
e. A unit transfer based on the need for an accessible unit.

6. Policies to Comply with Section 504 of the Rehabilitation Act of 1973, The Fair Housing Act Amendments of 1988 and Title VI of the Civil Rights Act of 1964.

a. Section 504 of the Rehabilitation Act of 1973 prohibits discrimination on the basis of disability in any program or activity receiving federal financial assistance from HUD.
b. The Fair Housing Act prohibits discrimination in housing and housing related transactions based on race, color, religion, sex, national origin, disability and familial status. It applies to housing, regardless of the presence of federal financial assistance.
c. Title VI of the Civil Rights Act of 1964 prohibits discrimination on the basis of race, color or national origin in any program or activity receiving federal financial assistance from HUD.

7. Policy for opening and closing the waiting list. The methods of advertising used to announce opening and closing of the waiting list should be described.

8. Eligibility of students. The plan must include the requirements for determining eligibility of students enrolled at an institution of higher education.

*9. *VAWA protections (applicable to the Section 8 program only). The plan, as well as House Rules where applicable, must include policies and procedures covering the VAWA protections. Owner policies must support or assist victims of domestic violence, dating violence or stalking and protect victims, as well as members of their family, from being denied housing or from losing their HUD assisted housing as a consequence of domestic violence, dating violence or stalking.*

(a) Owners must provide notice to Section 8 tenants of their rights and obligations under VAWA.
(b) Certification of Domestic Violence, Dating Violence or Stalking.
(1) Owners must provide tenants the option to complete the Certification of Domestic Violence, Dating Violence or Stalking, form HUD-91066. The certification form may be made available to all eligible families at the time of admission or, in the event of a termination or start of an eviction for cause proceeding, the certification may be enclosed with the appropriate notice, directing the family to complete, sign and return the form within fourteen (14) business days. The owner may extend this time period at his/her discretion.
(2) Alternately, in lieu of the certification form or in addition to it, owners may accept:
(i) A federal, state, tribal, territorial, or local police record or court record, or
(ii) Documentation signed by an employee, agent, volunteer of a victim service provider, an attorney, or medical professional from whom the victim has sought assistance in addressing domestic violence, dating violence, or stalking or, the effects of the abuse in which the professional attests under penalty of perjury under 28 U.S.C 1746 to the professional's belief that the incident or incidents are bona fide incidents of abuse, and the victim of domestic violence, dating violence or stalking has signed or attested to the documentation.
(3) Owners are not required to demand that an individual produce official documentation or physical proof of an individual's status as a victim of domestic violence, dating violence or stalking in order to receive the protections of the VAWA. Owners, at their discretion, may provide assistance to an individual based solely upon the individual's statement or other corroborating evidence. Owners are encouraged to carefully evaluate abuse claims as to avoid conducting an eviction based on false or unsubstantiated accusations.
(4) Owners should be mindful that the delivery of the certification form to the tenant via mail may place the victim at risk, e.g., the abuser may monitor the mail. Therefore,

in order to mitigate risks, owners are encouraged to work with the tenant in making acceptable delivery arrangements, such as inviting them into the office to pick up the certification form or making other discreet arrangements.

(c) Confidentiality of Information. The identity of the victim and all information provided to owners relating to the incident(s) of domestic violence, dating violence or stalking must be retained in confidence by the owner and must not be entered into any shared database or provided to a related entity, except to the extent that the disclosure is:

(1) Requested or consented to by the individual in writing;

(2) Required for use in an eviction proceeding; or

(3) Otherwise required by applicable law.

The HUD-approved certification form provides notice to the tenant of the confidentiality of the form and the limits thereof.

(d) Retention of information.

Owners must retain all documentation relating to an individual's domestic violence, dating violence or stalking in a separate file that is kept in a separate secure location from other tenant files.

(e) VAWA Lease Addendum.

Owners must have tenants sign the VAWA lease addendum, form HUD-91067 (see Chapter 8 for requirements on issuance of modifications to the model lease).

***NOTE:** See the Glossary for definitions for domestic violence, dating violence, stalking and immediate family member.**

D. Additional Owner Policies and Practices

1. General. In addition to the required content, owners are encouraged to incorporate their own policies and practices regarding the selection of tenants into the tenant selection plan. See Figure 4-2 for a list of recommended topics. By incorporating all policies and procedures in one plan, owners, applicants, and tenants will have one point of reference. Further, owners will have a single document to which they can direct applicants and tenants when questioned about policies and fairness of treatment.

2. Notification of modification to the tenant selection plan. It is also good practice for owners to include a description of the process used to provide notification to applicants on the waiting list and other interested persons (potential applicants) of the implementation of any new or revised tenant selection plan or policies that may affect an application or tenancy.

E. Modification of the Tenant Selection Plan

Owners should review tenant selection plans at least annually to ensure that they reflect current operating practices, program priorities, and HUD requirements.

F. Availability of the Tenant Selection Plan

When requested, the owner must make the tenant selection plan available to the public.

C. MORTGAGE STATUS.

1. Compliance Requirement. Owners shall promptly make all payments due under the note and mortgage.

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2. Suggested Audit Procedures.

a. Obtain a copy of the mortgage note, mortgage (or deed of trust), and associated loan amortization schedule to determine the terms and conditions of those agreements.
b. Obtain an understanding of the owner's procedures for assuring prompt payment of the mortgage.
c. **Determine whether all related mortgage and escrow payments were made by either**
(1) Obtaining or preparing a schedule of the client's mortgage and escrow payments and withdrawals for the period under audit (the schedule should include the amount, including escrow items, and date each item was paid or disbursed. Determine whether monthly payments were made on time and the loan was current at the end of the fiscal year) or
(2) Confirming the outstanding loan balance and annual escrow account activity with the lender as of the project's fiscal year end (determine whether monthly payments were made on time and the loan was current at the end of the fiscal year).
d. If the project is operating under a mortgage modification agreement, workout agreement, forbearance agreement, use agreement, or other agreement, determine whether the owner is complying with the terms and conditions of the agreement.

AHACPA Note – HUD has changed the procedure to allow for the auditor to choose between confirmation procedures or preparing a schedule. Previously both steps were required.

D. REPLACEMENT RESERVE.

1. Compliance Requirement. Owners, if required, shall establish a reserve for replacement account and make deposits in accordance with HUD requirements, usually the regulatory agreement *or business agreement. The reserve for replacement account is usually required to be under the control of the lender. Disbursements from the reserve for replacement fund may be made only after written consent is received from HUD.

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Reserve for replacement funds are to be invested in interest-bearing accounts for certain projects. Interest earned on these projects is required to be maintained in the reserve for replacement account. For other projects, HUD strongly encourages owners to invest the reserve for replacement funds. The mortgagee is authorized to invest funds in excess of $100,000 (the Federal Deposit Insurance Corporation (FDIC) federally insured limit) in approved securities and/or financial institutions as long as it follows the requirements in HUD Handbook 4350.1, paragraph 4-22. Interest on those investments is considered project funds and may not be disbursed directly to owners or directly to any individual associated with the project. All interest must flow through the project accounts and be disclosed in the accounting records.

2. Suggested Audit Procedures.
a. Obtain an understanding of the project owner's deposit and maintenance requirements included in the regulatory agreement,*business agreement and any

amendments or other written agreements with HUD and determine whether there were any changes to the funding requirement by

(1)Reviewing Form HUD-9250, Reserve Funds for Replacement Authorization, or

(2)Questioning the owner/management agent if any changes were made when rents were increased. Increases will be documented on Form HUD-92458, Rent Schedule Low Rent Housing.*

b. Obtain an understanding of the project owner's procedures for depositing, maintaining, requesting, and disbursing reserve for replacement funds.

c. Determine whether the reserve fund has been established in a federally insured depository under the control of the mortgagee, if required. *For funds in excess of federally insured limits, determine whether the owner/management agent reviewed the depository quarterly to verify that it met HUD requirements as described in HUD Handbook 4350.1.

*AHACPA Comment - **Ginnie MAE Bank Rating Requirement***

An issuer must be in compliance with these rating requirements in the month following the month in which an issuer's aggregate fixed installment control first generates $100,000 or more in principal and interest. Project loan escrow accounts, whether required by FHA, RHS or Ginnie Mae, for any project equal to or exceeding $100,000 are also subject to these requirements.

Acceptable Rating Agencies and Minimally Acceptable Ratings

Thompson Bankwatch	*C or better*
Moody's	*P-3 or better (short-term bank deposits)*
Standard & Poor's	*A-3 or better (short-term CDs)*

If custodial accounts are maintained with a funds custodian rated by one or more of the agencies named above, Ginnie Mae requires the following:

(A) If rated by all three agencies, the funds custodian must meet any two acceptable ratings.

(B) If rated by two agencies, the funds custodian must meet both acceptable ratings.

(C) If rated by only one agency, the funds custodian must meet that agency's acceptable rating.

If the funds custodian is not rated by any of the agencies listed above, Ginnie Mae will require that it meet minimally acceptable ratings from one of the following agencies:

Additional Rating Agencies and Minimally Acceptable Ratings

LACE Financial Corporation	*C or better*
Cates Bank Rating Service	*3.5 or better*

IDC Financial Publishing	*75 or better (Rank of Financial Ratio)*
Highline Rating Services	*47 or better*

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d. Using confirmation or the schedule prepared for the mortgage status compliance requirement in 3-5.C.2.c, determine whether all required deposits to the reserve for replacement were made in compliance with HUD requirements and agreements.
e. Determine whether all disbursements from the reserve for replacement account, identified in the mortgage confirmation or the schedule prepared in 3-5.C.2.c, were properly authorized by HUD.
f. Select a sample of repairs covered by funds from the reserve for replacement account. Trace the reimbursed amount to cancelled invoices and determine whether funds were used for the purpose authorized by HUD.

AHACPA Note –This sample must be from repairs disbursed form the R4R account. The sample items included here do not count towards other disbursement sample items required in other compliance sections

g. For projects for which HUD requires funds to be invested, determine whether funds were invested and interest was only withdrawn with HUD approval.
h. For projects for which HUD does not require funds to be invested, determine whether funds were invested. Perform the following steps:

(1). If funds were not invested, determine why and consider including a comment in the management letter or other auditor communication.

(2). If funds were invested, determine whether interest was disbursed to the project by the lender and if so, whether the interest was deposited into project accounts and recorded in the project's accounting records.

(3). If funds were invested, determine whether interest was disbursed directly to owners or any individual associated with the project in violation of HUD requirements.

E. <u>RESIDUAL RECEIPTS.</u>

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1. <u>Compliance Requirement</u>. Non-profit owners and owners of limited distribution projects, Section 202 projects, and Section 811 projects shall establish a residual receipts account and make deposits into the account in accordance with HUD requirements *within 90 days after the close of the fiscal year.* Disbursements from such fund may be made only after written consent is received from HUD.

2. <u>Suggested Audit Procedures.</u>

a. Obtain a copy of the project's regulatory agreement and any amendments or other HUD business agreements, to identify the project owner's requirements for making deposits into the residual receipts fund and copies of the surplus cash calculations from the end of the prior audit period and semiannual period, as applicable.
b. Obtain an understanding of the owner/management agent's procedures for determining and depositing residual receipts.

c. Determine whether the surplus cash calculations were prepared in accordance with the regulatory agreement and other HUD guidance.
d. Determine whether the project deposited all required amounts into the residual receipts account for the period under audit according to the surplus cash calculation(s).
e. Using the confirmation or the alternative schedule prepared for the mortgage status compliance requirement in 3-5C2c, determine whether residual receipts were deposited in the residual receipts account within *90* days after the end of the fiscal year or semiannual period, if applicable.
f. Determine whether disbursements from the residual receipts account, identified on the confirmation or alternative schedule prepared in 3-5.C.2.c, were properly authorized by HUD and used for the purpose intended.

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G. EQUITY SKIMMING.

1. Compliance Requirement. Equity skimming is the willful misuse of any part of the rent, assets, proceeds, income, or other funds derived from the project covered by the mortgage for any purpose other than to meet actual or necessary expenses of the project. Equity skimming deprives the project of needed funds for repairs, maintenance, and improvements, which contributes to the financial and physical deterioration of the project and the standard of living conditions for the families who depend on the federal government to provide housing. Also, a community where the project is located suffers since the project may become the breeding ground for crime, violence, and drugs. Appendix B includes areas disclosed in audit reports in which equity skimming was found in the operations of multifamily projects.

2. Suggested Audit Procedures. In the various compliance areas in this chapter, we have included audit steps that are designed to disclose equity skimming. The auditor should be aware of the conditions noted in appendix B and modify any of the audit steps based on the policies/procedures of the auditee.

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*Appendix B

Information on
Equity Skimming

This appendix discusses conditions that were found in audits of multifamily programs that are categorized as equity skimming. This information is included to help establish an understanding of equity skimming conditions.

Equity skimming is considered to be a fraud, which can be prosecuted through either criminal or civil statutes. When the auditor suspects equity skimming exists, the auditor must contact OIG's National Single Audit Coordinator, at 215-430-6733, to discuss the auditor's findings and the method used to report them.

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Review of Cash Disbursements and Expense Accounts. A review of cash disbursements and/or expense accounts of projects revealed use of project funds to pay for

(a) Maintenance, administrative, or other expenses of the owner, other programs, or other projects.
(b) Debts of the owners or management agent.
(c) Loans to owners, principals, or affiliate companies.
(d) Mortgages and related expenses not related to the project.
(e) Personal expenses, such as food, clothing, entertainment of wife and friends, private car expenses, etc., on a project credit card.
(f) Individual partner tax preparation or counseling fees (the preparation of the project tax return may be paid from operations).
(g) Legal fees for handling disputes among partners.
(h) Expenses related to arranging the sale of the project or part of the project.
(i) Splitting of fees with the management agent or others who provide services to the project. This can be an illegal kickback whereby a company agrees to refund a portion of its fees to an owner in return for awarding the management or services contract to the company.
(j) Theft of funds in which owners or management agents may write checks to themselves or relatives and not try to hide the fact that they have taken the funds.
(k) Expenses to identity-of-interest companies when

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(1) The identity-of-interest company is a conduit for the purchase of materials and supplies and adds on an excessive percentage markup beyond what it needs to cover its own costs.
(2) The identity-of-interest company is paid for labor and materials to repair the project but is using on-site maintenance staff and/or materials to do the work.
(3) The identity-of-interest company is leasing equipment to the project at rates significantly in excess of those charged on the open market.
(4) No work was ever done. The identity-of-interest company may not actually exist, and the bank account may be used to launder funds.
(5) The cost for property and liability insurance for the project is in excess of prices charged on the open market or for coverage that is inadequate to protect HUD's interests.
(6) The identity-of-interest company provides insurance for the property under a blanket policy covering several HUD and non-HUD properties. The owner or management agent may be prorating an excessive amount to the HUD properties and using the excess reimbursement to offset insurance costs for its non-HUD projects or as a means to divert project funds.

Review of Project Income.

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A review of cash receipts and/or revenue accounts of projects revealed that

(a) Rental units were used for owner activities without HUD approval and no rent was collected for the unit.
(b) Income from contracted services such as laundry services, cell tower leases, and cable fees to tenants was retained by the owner.
(c) Units were recorded as vacant but were actually rented. The rent received was split between the owner and the management agent.*

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F. DISTRIBUTIONS TO OWNERS.

1. Compliance Requirement. Owners may not make, receive, and/or retain any distribution of assets or any income of any kind of the project except surplus cash and then only under certain conditions. Surplus cash distributions can only be made as of and after the end of a semiannual or annual fiscal period. Surplus cash distributions cannot be made when the owner is in default under any of the terms of the regulatory agreement, the note, or mortgage. Surplus cash distributions cannot be made out of borrowed funds or if the owner has not complied with all outstanding notices, from HUD or from the mortgagee, for proper maintenance of the project.* 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, business agreement or subsequent HUD-approved agreements with the balance of surplus cash required to be deposited in a residual receipts account (see steps 3-5.E).

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2. Suggested Audit Procedures.

a. Obtain a copy of the project's regulatory agreement, business agreement and any amendments or associated documents to determine the owner's rights for receiving distributions and surplus cash calculations for the prior fiscal period and semiannual period, if applicable.
b. Obtain an understanding of the owner/management agent's procedures for determining surplus cash and making distributions.
c. Scan minutes of board or partnership meetings for discussions authorizing distributions.
d. Question the owner or management agent about the existence of any notices of default or other items of noncompliance under any of the terms of the regulatory or business agreement.
e. Determine whether the surplus cash calculations were prepared in accordance with the regulatory or business agreement and other HUD guidance.
f. Determine whether distributions taken during the audit period exceeded the amounts calculated and/or authorized for that period.

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g. Scan cash disbursements for evidence of any payments made to the project owners *or related parties. Scan journal entries for unexplained decreases in accounts payable, notes payable, and related interest to project owners or related parties. Determine whether the owner/ management agent paid partnership management fees, asset management fees, incentive management fees, and write-offs of related party receivables from funds other than surplus cash or distributions.

h. Scan the bank statements for any deposit, from the project owners and/or related parties, which would evidence that incorrect distributions or payments were made and that those funds were redeposited into the project's accounts before the audit.
i. Review inspection reports and owner responses to verify compliance with all outstanding notices for proper maintenance of the project. Delays in making repairs could erroneously result in surplus cash being reported to be on hand at the end of the reporting period, making funds available for distribution to the owners.

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Unauthorized Distributions

- Definition: Any taking of project funds or assets other than surplus cash distribution under the regulatory agreement
- Results in referral to either a HUD Field Office or the Enforcement Center and maybe to QASS as well

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OK to take a distribution when

- There is surplus cash available from the prior accounting period.
- Construction has been completed
- All cost certification submissions are complete
- Project is in good repair and condition

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Not OK to Take Cash

- When there's no surplus cash
- From borrowed funds
- Prior to completion of Project
- When the Project is in default
- While the Project is under a forbearance agreement

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Other Methods REAC Has Seen

- Unauthorized
  - Loans from project funds
  - Acquisition of Liabilities
  - Management Fees
  - Withdrawals from Residual Receipts Account

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HUD Takes an Extra Look at:

- Loan Payments (unless terms indicate that payments must be made from surplus cash
- Transactions due to construction of a new project
- Entity/Construction Financing Activities (unless details OK payment from surplus cash or repayment of entity expenses)

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Slam Dunk Findings

- If these are paid from the project operating account:
- Any distributions
- Entity expenses (e.g. legal fees, asset management fees, syndication fees, general partner fees)

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Surplus Cash Reminder

- Surplus cash = total cash less total current obligations

- For profit motivated projects: equals the amount available for distribution in the next fiscal period
- For nonprofit project: equals the amount due to the Residual Receipts account
- For Limited Dividend Projects: Part B of the Computation should be completed to determine distributions and/or residual receipts

Computation of Surplus Cash

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- Surplus cash is a HUD calculation
- It is based on balance sheet information
- Surplus Cash equals "Total Cash" less "Total Current Obligations"

Determining Total Cash

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- S1300-010 Cash
  - S1300-010 Cash = 1120 Cash – operations + 1170 Short Term Investments – operations + 1191 Tenant/Patient Deposits Held in Trust.
  - The system performs a validation check on this number to ensure it matches the balance sheet totals.

- 1135 Accounts Receivable-HUD
  - This account is pulled directly from the Balance Sheet and automatically populates the Computation of Surplus Cash.

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- S1300-030 – Other Should include:
  - Reserve for Replacement withdrawals which have been approved by HUD but not yet received
  - Medicare/Medicaid Receivables receipt expected within 60 days
  - Account 1165 Interest Reduction Payment Receivable

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Should <u>not</u> include
- Entity/Construction Cash Accounts
- Tenant Accounts Receivable
- Accounts/Notes Receivable from Related Parties
- Insurance Receivables
- Escrow Deposits

Determining Total Current Obligations

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- S1300-050 Accrued Mortgage Interest Payable
  Includes the following:
  - Account 2131 – Accrued Interest Payable – First Mortgage
  - Account 2130 – Accrued Interest Payable – Section 236
  - Account 2132 – Accrued Interest Payable – Other Mortgages if payable out of project operations

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- S1300-060 Delinquent Mortgage Principal Payments
  - This Account will equal S1000-010 – Required Principal Payments less S1200-360 Payments made per the Statement of Cash Flows

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- S1300–070 Delinquent Deposits to Reserve for Replacements
  - This Account equals S1000-020 – Required Deposits less Account 1320DT – Deposits Made unless Account 1320R - Deposits Suspended or Waived Indicator is <u>*Yes*</u>

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- S1300-075 Accounts Payable – 30 days
  - This account should include the portion of balance sheet accounts due within 30 days.
  - This account should not include any Entity/Construction Payables

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- S1300-080 Loans or Notes Payable [within 30 days]
  - This account should not include
    - Principal due on the Mortgage
    - Loans or Notes payable out of surplus cash
    - Owner Advances
      - Only Notes approved by HUD to be paid out of project operations should be included.

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- S1300-090 Deficient Escrow Deposits
  - This should *not* include liabilities for taxes and insurance
  - This should include escrow deposits less the prorated amount due at FYE (i.e. 3/12 of insurance premium if the premium is due 9/30 and project has 12/31/FYE)
  - Should match the mortgagee's escrow analysis.

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- S1300-100 Accrued Expenses
  - This account should include accrued expenses expected to by paid within 30 days.
  - This account should *not* include amounts escrowed such as property taxes, insurance and MIP
  - Entity/Construction Payables should *not* be included

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- 2210 – Prepaid Revenue
  - This account is pulled from the Balance Sheet and automatically populates the Computation of Surplus Cash.

- 2191 – Tenant Security Deposit Liability
  - This account is pulled from the Balance Sheet and automatically populates the Computation of Surplus Cash.

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- S1300-110 Other Current Obligations
  - This account may include Bank Overdrafts, Accounts Payable or Accrued Expenses not included above, R4R Withdrawals not expended, Insurance Proceeds not expended, Delinquent Residual Receipts deposits, prior year delinquent R4R deposits
  - This account should also include the include the following
    - Next month's principal and R4R deposit if you have a 2011 agreement;
    - Next month's principal and R4R deposit, plus MIP and escrows if the project has a 2014 Regulatory Agreement
  - This acct should not include any Owner Advances or Accounts Payable – Entity/ Construction

Surplus Cash

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- Total Cash less Total Current Obligations

- For Profit Motivated Projects: equals the amount available for distribution in the next fiscal period
- For Nonprofit Projects: equals the amount due to the Residual Receipts Account
- For Limited Dividend Projects: Part B of the Computation should be completed to determine distributions and/or residual receipts

Mid-Year Computation of Surplus Cash

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- Some Project Regulatory Agreements allow for distributions every 6 months.
- These Projects may include a Mid-Year Computation of Surplus Cash (it is not required unless the Owner takes a Mid- Year Distribution).
- If a Limited Dividend takes a Mid-Year Distribution they must also make any required Residual Receipts Deposits.
- The mid-year computation should be submitted electronically as it is subject to the same audit guidelines as other supporting data schedules.

AHACPA COMMENTS ON CASH CONTROLS AND OTHER REQUIREMENTS

2-5. MINIMUM NUMBER OF BANK ACCOUNTS

77

Under terms of the regulatory agreement, each Project must maintain in Federally insured banks, the following minimum number of bank accounts:

- *Regular Operating Account*
- *Replacement Reserve (Held by the mortgagee, except for Section 202s)*
- *Tenant Security Deposit Account (Only if security deposits are received)*
- *Residual Receipts Account (Held by mortgagee, except for Section 202)*

2-6. REGULAR OPERATING ACCOUNT

78

A. The Regular Operating account is a general operating account for the project which is used for depositing rental receipts and other receivables not specifically designated for the Security Deposits Account. The account also is used to pay operating expenses of general administration including mortgage payments, management fees, utilities and maintenance. The Regulatory Agreement states that the funds must be maintained in a separate account. However, this paragraph suspends the operation and effect of this Regulatory Agreement provision by authorizing the management agent to hold funds in a centralized account, up to or exceeding $100,000, in institutions under the control of, and whose deposits are insured by, the Federal Deposit Insurance Corporation, National Credit Union Association, or other U. S. government insurance corporations under the following conditions:

1. Managing agents must determine that the financial institution has a rating consistent at all times with current minimally acceptable ratings as established and published by Government National Mortgage Association (GNMA).

2. The managing agent must monitor the institution's ratings no less than on a quarterly basis, and change institutions when necessary. The managing agent must document the ratings of the institution where the funds are deposited and maintain the documentation in the administrative record for three years, including the current year.

3. In the event that the managing agent fails to follow these procedures and the bank fails, the owner/managing agent will be expected to make up losses sustained by the various project accounts held by the failed bank.

4. Deposits to and disbursements from the centralized account must clearly be traceable to each project. The actual cash position of each and every project in the centralized account must be easily identifiable at all times without exception.

5. The managing agent must allow a project owner to require, at any time, that the particular owner's funds be kept isolated and separate from the funds of other projects held by the agent; that is, at all times an owner is to have the prerogative of not participating in the centralized account arrangement or of withdrawing from such an arrangement.

NOTE: The above language is not deemed a modification of the Regulatory Agreement. Therefore, HUD reserves the right to invoke this Regulatory Agreement provision and make it operational in the future through notice or handbook change, if it is determined that such a policy is necessary or desirable.

B. Subsidiary Centralized Accounts. Many businesses find it convenient to maintain separate, subsidiary accounts for payroll. Separate payroll accounts usually facilitate auditing and recordkeeping, particularly where frequent deposits are made to the special escrows required for payroll withholding taxes. The Department has decided to allow the establishment of separate, subsidiary payroll accounts within the centralized account arrangement.

2-12. CASH MANAGEMENT CONTROLS

79

GENERAL

1. All cash receipts (including those collected by management agents) must be deposited in the name of the project in a bank or banks whose deposits are federally insured. When the $100,000 insurance limit would be exceeded, the owner/managing agent shall follow the banking procedures described in paragraph 2-6 of Handbook 4370.2. Such funds shall be withdrawn only in accordance with the provisions for project expenses or for distributions of surplus cash. Any owner receiving funds of the project, other than by such distribution of surplus cash, shall immediately deposit such funds in the project bank account.

2. Any funds collected as security deposits must be kept separate and apart from all other project funds in an account maintained in the name of the project. The balance of the account must not at any time be less than the aggregate of all outstanding obligations under the account for security deposits.

3. *As insurance against loss, the owner or his designated agent must obtain a fidelity bond in an amount at least equal to potential collections for two months. Blanket coverage should extend to all employees handling cash.*
4. *Numbered rent receipts shall be used and reconciled to actual collections.*
5. *The person making up deposits shall not handle the accounts receivable or the general ledger.*
6. *Disbursement checks shall be identified with all relevant account numbers and amounts applicable to each account when one check is for more than one invoice/bill.*
7. *The person preparing the payroll shall not handle the related pay che*cks.
8. *Unissued checks should be locked up and access to checks should be restricted to a limited number of authorized personnel.*

RECEIPT CONTROLS

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1. *Collections and all other funds held within an office, whether pending regular deposit or in interest funds, shall be completely controlled under proper safeguards, preferably in a fire-resistant combination safe or safe-cabinet.*
2. *An adequate recording system shall be employed to note all checks received and deposited.*
3. *Insofar as is possible, all collections shall be promptly deposited on the day received.*
4. *Bank statements shall be reconciled promptly to the formal accounting records by persons other than those recording or handling cash, or preparing and signing checks.*

H. CASH RECEIPTS.

1. Compliance Requirement. All cash receipts, including those collected by a management agent, must be deposited into an account in the name of the project at an institution in which deposits are federally insured. The project's owner must verify that depositories where it maintains funds in excess of $100,000 meet certain conditions as outlined in chapter 2 of HUD Handbook 4370.2.

Most projects will have at least three bank accounts including a regular operating account, a reserve for replacement account (held by the mortgagee, see paragraph 3-5.D for audit steps), and a tenant security deposit account (see paragraph 3-5.L for audit steps). Non-profits and limited distribution projects will also have a residual receipts account (see paragraph 3-5.E for audit steps).

The regular operating account is a general operating account in the name of the project, which is used for depositing receipts of the project other than those specifically designated for the security deposits account. A centralized account can only be used as provided for in chapter 2 of HUD Handbook 4270.2.*

2. *Suggested Audit Procedures.

81 & 82

a. Obtain an understanding of the owner/management agent's procedures for handing cash receipts.

b. Determine whether the project owner's written and actual procedures for receiving and depositing funds in the regular operating account/centralized account are in compliance with the regulatory agreement and chapter 2 of HUD Handbook 4370.2.
c. Determine whether the account is exclusively in the name of the project except as allowed by HUD Handbook 4370.2 for centralized accounts.
d. Select a sample of deposits from the cash receipts ledger and perform the following steps:

(1) Determine whether the deposits were made in a timely manner after receipt of funds and are in the name of the project. Usually tenant cash receipts are deposited daily during the heavy rent collection days during the first part of the month and when certain amounts of funds are accumulated during the rest of the month.
(2) Test the supporting documentation for each deposit in the sample and determine whether all funds that were received were properly accounted for and included in the deposit.
(3) Determine that all deposits in the books of account are in agreement with the related bank statements as to amounts and dates.
(4) Determine whether the deposits were posted to the appropriate general ledger accounts.
(5) Trace all amounts other than tenant/member rental receipts to any contracts, agreements, or other documentation and determine whether the amount that was received was properly deposited and posted to the appropriate account.
(6) Select a sample of tenant/member rental receipts and trace the amount from the source documents to the individual tenant/member accounts receivable record and their executed leases.
(7) If any amounts are added to the account by way of an institution's memorandum or other type of document, determine the reason for that transaction and whether it was proper.

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AHACPA Comment – The sample mentioned in step 2.d.(6) requires a sample of tenant/member receipts to trace to the tenant receivables does not represent a separate sample. Rather it is a subset of the original sample chosen in step 2.d. above. This sample does not require an additional calculation of sample size in accordance with the guidelines published above.

e. Owners may be motivated to both understate and overstate revenue. The following audit steps are designed to disclose such occurrences:

(1) Consider the fraud risk factors and the potential for material misstatement of the financial statements related to revenue recognition including vacancy loss and bad debt expense. Perform testing to address any material fraud risk factors identified. The auditor should tailor audit steps/procedures based on the individual risk factors identified and the results of other audit evidence gathered.

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(2) Determine whether vacancy loss is greater than 15 percent of total rental revenue or if the change in vacancy loss between the current year and prior year is greater than 5 percent. If so, the following steps should be performed:

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i. Determine whether rent potential and vacancy loss were properly calculated.

ii. For all revenue accounts, scan the detailed general ledger. Review the supporting documentation for all material manual entries and unusual entries.

iii. Determine the reason for the increase or cause of the high vacancy rate via discussion with management. The auditor may also want to select a sample of vacant units and perform tests to substantiate the high vacancy rate. Possible tests on the sample include but are not limited to the following:

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(i). Reviewing the move-out notice from the tenant.

(ii). Reviewing the documentation from the move-out inspection.

(iii). Determining whether the security deposit was refunded to the tenant.

(iv). Reviewing the itemized list of damages and charges provided to the tenant, which was used to reduce the amount of security deposit due back to the tenant.

(v). Inspecting the vacant unit if the unit is still unoccupied.

(vi). Questioning site personal, including the resident manager and the building manager, to determine the period when the unit was vacant.

(vii). Reviewing work orders to determine the period when the unit was vacant.

(3) Determine whether bad debt expense is greater than 10 percent of total rental revenue or whether the change in bad debt expense is greater than 5 percent between the current year and the prior year. If so, the following steps should be performed:

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i. Obtain an understanding of the owner/management agent's procedures for collecting delinquent debt and policy for writing off debt.

ii. Determine whether delinquent accounts are sufficiently pursued according to procedures.

iii. Select a sample of accounts written off to bad debts expense and review supporting documentation to determine whether debt was written off in accordance with policy and generally accepted accounting principles.

AHACPA Comment – Although the requirement for both vacancy loss and bad debt expense is based a percentage of total revenue or change from the prior year amount, the auditor is not required to investigate amounts that are below materiality limits. For instance, if vacancy loss went from $1,000in 2007 to $2,000 in 2008; a net increase of 100%, the auditor would not be required to investigate the change if overall tolerable error was greater than the total vacancy loss. Again, practitioners will have to exercise significant judgment in applying these tests.

AHACPA Comment on 4370.2 Documentation

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E. All disbursements from the Regular Operating Account (including checks, wire transfers and computer generated disbursements) must be supported by approved invoices/bills or other supporting documentation. The request for project funds should only be used to make mortgage payments, make required deposits to the Reserve for Replacements, pay reasonable expenses necessary for the operation and maintenance of the project, pay distributions of surplus cash permitted and repay owner advances authorized by HUD.

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DISBURSEMENT CONTROLS.

1. *A request for a check must have supporting documentation (i.e., invoice itemizing amount requested with an authorized signature) in order for approval to be obtained to make the disbursement.*
2. *Checks must be approved by an individual authorized to approve checks.*
3. *The authorized check signer shall review supporting documentation before signing the check.*
4. *Supporting vouchers shall be marked canceled to prevent resubmission.*
5. *A monthly reconciliation shall be performed to ensure that all checks disbursed are accounted for (i.e., cashed, outstanding, or void).*
6. *Invoices should be marked "paid" and the check number and date should be posted to the invoice. Supporting vouchers shall also be marked "paid" to prevent resubmission.*

I. CASH DISBURSEMENTS.

1. Compliance Requirement. All disbursements from the regular operating account must be supported by approved invoices, bills, or other supporting documentation. Project funds should only be used to pay for mortgage payments, required deposits to the reserve for replacement fund, reasonable expenses necessary for the operation and maintenance of the project, distributions of surplus cash as permitted, and repayment of owner advances from surplus cash or as authorized by HUD. Disbursements from a centralized account must clearly be traceable to each project. The actual cash position of each project in this account must be easily identifiable at all times without exception.

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2. Suggested Audit Procedures.
   a. Obtain an understanding of the project owner/management agent's procedures for withdrawing funds from the regular operating account or centralized account and determine whether they are properly supported and used in accordance with the regulatory agreement.
   b. Select a sample of disbursements from the cash disbursement ledger or similar record and perform the following steps:
      (1) For centralized accounts, determine whether the disbursements were recorded in the books of the appropriate project in accordance with HUD

Handbook 4370.2. Review cash account balances of each project to ensure that balances are easily identifiable to each project. Also, determine whether any projects have a negative or zero balance, which could indicate an improper loan between projects.

(2) Determine whether the disbursements are supported by approved invoices, bills, or other supporting documentation; the supporting documents are in the name of the project; and the costs are reasonable and necessary for the operation of the project. If the supporting documentation is not in the name of the project, determine whether only the portion applicable to the project was paid from project funds.

(3) Determine whether the disbursements were made on behalf of other projects or entities since project funds cannot be loaned or used for nonproject purposes. **Report instances even if amounts have been repaid.**

(4) Determine whether the disbursements were properly charged to the correct account.

c. Scan the cash disbursements journal for payments that would evidence actual or potential litigation for any discriminatory rental practices.

d. If any amounts are withdrawn from the project account by way of an institution's memorandum or other type of document, determine the reason for that transaction and that it is proper.

e. For accounts with balances in excess of FDIC-insured limits, determine whether the owner or management agent followed the steps outlined in chapter 2 of HUD Handbook 4370.2 to determine the eligibility of the financial institution.

AHACPA Comment – The CPA should understand that if the disbursements are handled through a centralized account, the testing must be performed on a project by project basis. Each project in the centralized account must have a separate sample selected for testing. Further, the requirement to review memorandum entries could apply to both the general ledger and the bank account. The auditor should be aware of unusual items occurring in either location.

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J. TENANT APPLICATION, ELIGIBILITY, AND RECERTIFICATION.

1. Compliance Requirement. Owners who participate in HUD's rent subsidy programs are responsible for accepting applications, maintaining a waiting list, determining eligibility, calculating the tenant's contribution toward rent and utilities, calculating subsidy, and recertifying the tenant annually in accordance with HUD requirements.

2. Suggested Audit Procedures.
   a. Obtain a copy of the housing assistance payments contracts or equivalent subsidy contracts with any amendments to determine the owner's responsibilities in this compliance area.
   b. Obtain an understanding of the owner/management agent's procedures for accepting applications, managing the waiting list, determining initial eligibility,

determining a tenant's rent and subsidy, and recertifying annually and determine whether they are in compliance with the provisions in HUD Handbook 4350.3.

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c. Review the results of any field reviews performed covering tenant application, eligibility, and recertification activity. Consider the impact on the audit steps to be preformed. If deficiencies were disclosed, additional testing should be performed on current activity to determine whether the problem has been corrected or corrective action was put in place.

AHACPA Comment – Although the procedures described above call for the CPA to review the results of any field reviews, this work cannot be used to reduce the scope of testing by the CPA. It may be used to assist in determining risk assessment and even evaluating controls, however, the sample selection described above will not be reduced as a result of a favorable filed review by the contract administrator. The following worksheets outline the testing to be performed during the filed review.

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d. Select a sample of applicants that were selected from the waiting list during the fiscal year. The sample should include some tenants that were denied admission. Perform the following steps at a minimum:

(1) Determine whether applicants were selected in the correct order.
(2) Determine whether preferences granted were verified before admitting the applicant as a tenant, if applicable.
(3) Determine whether the waiting list was purged. If so, determine whether it was done in accordance with written procedures.

AHACPA Comment - Waiting Lists 4350.3 Chapter 4-16

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A. ***Key Requirements***

1. *Receiving and recording the application. Upon receipt of an application for tenancy or assistance, the owner must indicate on the application the date and time received. This may be accomplished by either using a date and time stamp or by writing and initialing the date and time received. The owner must then either process the applicant for admission, place the applicant on the waiting list or, based on a preliminary eligibility determination, reject the applicant. Examples of applicants who might be rejected based upon a preliminary eligibility determination include a 35-year old individual applying for a unit in a Section 202 PRAC property, a household of eight applying to a property with only efficiency and one bedroom units, and an applicant with income that is $7,000 over the income limit.*
2. *Preferences. Owners must collect information about the preferences for which the applicant qualifies so that they are able to select applicants from the waiting list in accordance with preferences established for the property. (See paragraph 4-6 for additional information about preferences.)*
3. *Providing notice. The owner must provide notice of closing of the waiting list.*

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B. ***Opening and Closing the Waiting List***

Owners should monitor the vacancies in their properties and their waiting lists regularly to ensure that there are enough applicants to fill the vacancies. Furthermore, owners should monitor their waiting list to make sure that they do not become so long that the wait for a unit becomes excessive.

1. *Closing waiting lists.*
   a. *The waiting list may be closed for one or more unit sizes when the average wait is excessive (e.g., one year or more).*

b. When the owner closes the list, the owner must advise potential applicants that the waiting list is closed and refuse to take additional applications.

c. When the owner decides to no longer accept applications, the owner must also publish a notice to that effect in a publication likely to be read by potential applicants. The notice must state the reasons for the owner's refusal to accept additional applications.

2. *Opening waiting lists.*

a. When the owner agrees to accept applications again, the notice of this action must be announced in a publication likely to be read by potential applicants in the same manner (if possible, in the same publications) as the notification that the waiting list was closed. The notifications should be extensive, and the rules for applying and the order in which applications will be processed should be stated.

b. Advertisements should include where and when to apply and should conform to the advertising and outreach activities described in the Affirmative Fair Housing Marketing Plan.

C. ***Determining an Applicant's Preliminary Eligibility***

1. *Owners should make a preliminary eligibility determination before putting a household on the waiting list.*

a. The owner reviews the application to ensure that there are no obvious factors that would make the applicant ineligible.

b. If a preliminary screening indicates that a family is eligible for tenancy, but units of appropriate size are not vacant, the owner must place the family on the waiting list for the property and notify the family when a suitable unit becomes available. A final eligibility determination is made at the time the unit is available. (See discussion of unit size determinations in paragraph 3-23.)

c. Using this system, the owner avoids performing the eligibility determination twice before admitting the applicant to the property, but the result may be that applicants placed on the waiting list may ultimately be found to be ineligible.

2. **If the preliminary screening indicates that a family is eligible for tenancy but SSNs have not been disclosed and verification of the SSN provided for the applicant and all of the applicant's household members, the owner must place the family on the waiting list and notify the family when a suitable unit becomes available. However, the applicant must disclose and provide verification of a SSN for all household members before they can be admitted. See Chapter 3, Paragraph 3-9 for more information on disclosing and verifying SSNs.*
3. *Alternatively, owners may choose to place applicants on the waiting list after making a more in-depth eligibility determination. If a property's waiting list is short, this approach can be a good practice to help place applicants quickly when they reach the top of the waiting list. However, if an applicant remains on the waiting list for an extended period of time, the owner will need to complete another full determination once the applicant reaches the top of the list.*
4. *If an applicant is otherwise eligible for tenancy but no appropriate size unit exists in the property, the owner must reject the application. (See paragraph 4-9 for more information about rejecting applicants.)*
5. *Applicants who are obviously not eligible for tenancy must be rejected.*

D. ***Creating Waiting Lists***

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To ensure that applicants are appropriately and fairly selected for the next available unit, it is essential for owners to maintain waiting lists with appropriate information taken from the application for tenancy.

1. *Plan of list maintenance. In order to ensure that all applicants are treated fairly, the tenant selection plan must describe how the waiting list is maintained.*
2. *Updates of waiting list. Keeping the waiting list as up-to-date as possible will help reduce errors and minimize the administrative resources expended on processing information regarding applicants who are ineligible or no longer interested in residing in the property.*

a. Owners may periodically update their waiting lists.

b. Owners may require applicants to contact the property every six months in order to stay on the waiting lists.

3. *Data included on the waiting list. The waiting list must include the following data taken from the application:*
   a. Date and time the applicant submitted an application;
   b. Name of head of household;
   c. Annual income level (used to estimate levels for income-targeting, i.e., extremely low-income, very low-income, and low-income) (See discussion of income limits in paragraph 3-6);
   d. Identification of the need for an accessible unit, including the need for accessible features;
   e. Preference status; and
   f. Unit size.
4. *Excluding data from the waiting list. While additional information, such as race/ethnicity, gender, and family size is collected on pre-applications and applications and retained in property files, it is good practice to avoid including these types of data on the property waiting list. This information is not directly relevant to tenant selection and might result in discrimination against some applicants.*
5. *Applicant presence on multiple waiting lists. An applicant may be on multiple waiting lists (or waiting for more than one unit size). Based upon the application dates and times and qualification for preferences (if used), placement on these multiple lists may vary.*

4-18 Documenting Changes to Waiting Lists

A. Overview

Whenever a change is made in the waiting list, an action is taken, or an activity specific to an applicant occurs, a notation must be made on the waiting list.

B. Providing an Auditable Record of Changes to Waiting Lists

The goal of the annotation is to provide an auditable record of applicant additions, selections, withdrawals, and rejections. Independent reviewers looking at the waiting list should be able to:

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1. *Find an applicant on the waiting list;*
2. *Readily confirm that an applicant was housed at the appropriate time based on unit size needs, preferences, and income-targeting; and*
3. *Trace various actions taken with respect to a family's application for tenancy.*

C. Maintaining Documentation of the Waiting Lists

Owners must develop a method to maintain documentation of the waiting list composition, application status, and actions taken.

1. *The method adopted by an owner will vary based upon the level of automation used at the property.*
2. *Owners should periodically analyze their waiting list policies and documentation procedures to determine whether an independent party reviewing the list and its supporting documentation could follow the actions taken, applicable preferences, and reasons why certain individuals may have been selected ahead of others on the waiting list. If not, the owner must make the waiting list format and associated practices more transparent.*

D. Maintaining Records of Manually Recorded Waiting Lists

An owner may keep a manual property waiting list.

1. *Manually maintained waiting lists must be maintained as a permanent record.*
   a. The list must not be "rewritten."
   b. The list must be maintained in a manner that cannot easily be altered.
   c. The list must be kept in a manner that can be audited.
2. *The manual waiting list must provide an easily viewable record of the date and time of application, and date and time of selection from the waiting list.*

E. Maintaining Records for Electronic Waiting Lists

Owners may maintain an electronic waiting list (instead of a manual property waiting list).

1. *Electronic waiting lists must have a mechanism for maintaining the date and time of each applicant's placement on or selection from the waiting list and a way to document changes made to the list. The following are examples of methods that owners might use to track inputs to the electronic waiting list and changes to it.*
   a. Use a data backup function to record the time and date of entry of new applications and changes to existing records in the electronic waiting list.

b. Print a record of the appearance of the waiting list as often as necessary (at least monthly) to show each applicant's placement on and selection from the list. The time and the date of the printout should appear on the report. The owner can file this information in the tenant file and in a central waiting list selection file.

c. Whenever status changes occur, such as changes in family composition and unit size, the change should be recorded with an explanation, and the re-sorted list should be printed.

2. *To the extent possible, the owner should use electronic safeguards, such as assigning waiting list password access only to individuals responsible for maintaining the system. Ideally, a system should record the user name and the time, date, and action entered whenever a record is changed or entered in the electronic waiting list.*

4-19 Updating Waiting List Information

A. *The owner should update the waiting lists annually or semi-annually to ensure that applicant information is current and that any names that should no longer be on the list are removed.*
B. *If the household composition changes, the owner must update the waiting list information and decide whether the household needs the same or a different unit size. The owner's written policy will determine if the family maintains the original application date or if the place on the waiting list is based on the date of the new determination of family composition.*
C. *The owner must establish occupancy standards as part of the property's tenant selection plan and consistently apply those standards in assigning unit size to applicants. (See paragraph 3-23 for more information about occupancy standards.)*
D. *If the applicant contact information changes, such as the address or phone number, the owner must note the new information and the date it was received on the application submitted by the family and must ensure that the waiting list (either manual or electronic) is accurately updated.*

4-20 Removing Names from the Waiting List (Purging the Wait List)

The owner must document removal of any names from the waiting list with the time and date of the removal.

A. *The tenant selection plan must include a written policy that describes when applicant names will be removed from the waiting list. Examples of applicant removal policies an owner may adopt are:*
   1. *The applicant no longer meets the eligibility requirements for the property or program;*
   2. *The applicant fails to respond to a written notice for an eligibility interview;*
   3. *The applicant is offered and rejects two units in the property (or any number of unit offers as specified in the owner's written policies);*
   4. **The applicant fails to provide SSNs for all household members.**
   5. *Mail sent to the applicant's address is returned as undeliverable; or*
   6. *The unit that is needed – using family size as the basis – changes, and no appropriate size unit exists in the property.*
B. *The owner must periodically print out electronic waiting lists or preserve backup copies showing how the waiting list appeared before and after the removal of each name.*

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4-23 General

A. *Once an owner has solicited applications and developed a waiting list for applicants for whom no unit is immediately available, the owner must select applicants from the waiting list and offer units in the order required by HUD rules and owner policies. This section describes options for the owner and provides guidance on how to carry out these activities.*
B. *When a unit becomes vacant, the owner must select the next applicant from the waiting list based on the unit size available, preferences established for the property, income-targeting policies and requirements, *disclosure and verification of SSN(s)* and screening policies applied by the owner. The owner will select the first name on the waiting list for the appropriate unit size (or list of names for units reserved for disabled applicants) and make a final determination of eligibility and suitability for tenancy, using the criteria described in Chapter 3, Sections 1 and 2, and the procedures in this section.*

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4-24 Applicant Interviews

A. When an appropriate unit will be available in the near future, the owner must interview an applicant and obtain current information about the family's circumstances. For documents that an owner may ask applicants to bring to the interview, see Exhibit 4-1.

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B. At the interview, the owner must:

1. *Confirm and update all information provided on the application. If a preapplication was submitted, complete a full application form and confirm and update the information.*
2. *Explain program requirements, *including use of the information contained in the EIV system*, verification procedures, and penalties for false information. The penalties include eviction, loss of assistance, fines up to $10,000, and imprisonment up to five years.*
3. *Obtain family income and composition information and other data needed to verify eligibility and compute the tenant's share of the rent. (See Chapter 5.)*
4. *Review the financial information on the application and specifically ask the tenant whether any member of the household:*
   a. *Receives any of the types of income listed in Chapter 5, Section 1 (e.g., self-employment income, unemployment compensation, income maintenance payments). If it appears likely that an applicant is receiving a form of income not reported on the application, ask the applicant about that source of income and document the applicant's response in the file; and*
   b. *Has any assets. (See paragraph 5-7 for a description of assets.)*
5. *Ask the head of household, spouse, or co-head, and household members age 18 and over to sign the release of information consent portion of the Authorization for Release of Information (Forms HUD 9887 and 9887-A) and any other necessary verification requests.*
6. *Obtain declaration of citizenship (see Exhibit 3-5) and verification consent forms (see Exhibit 3-6) for verification from all household members as appropriate.*

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7. *Inform the applicant of the screening requirements used by the owner, *including use of the Existing Tenant Search in EIV for determining if the applicant, or a member of the applicant's family, is receiving HUD's rental assistance at another location.* (If the owner performs screening activities, a consent to check landlord or credit history should also be obtained).*
8. *Require the head of household, spouse, or co-head to give a written certification as to whether any family member did/did not dispose of any assets for less than fair market value during the two years preceding the effective date of the certification/recertification.*
   a. *The certification must include a list of all assets disposed of for less than fair market value, the dates disposed of, the amount received, and the asset's market value at the time of disposition.*
   b. *HUD does not prescribe a form for this certification. It may be part of an application form or a separate form.*

   ***NOTE:** Owners need not obtain this information if the family is being considered only for a unit in a BMIR project without rental assistance because the disposal of assets does not affect income and rent calculations for BMIR tenants who do not receive rental assistance.*

9. **Require disclosure and verification of SSNs for all household members, except those who do not contend eligible immigration status, and tenants age 62 or older as of January 31, 2010, whose initial determination of eligibility was begun before January 31, 2010, and provide verification of the complete and accurate SSN assigned to them. (See paragraph 3-9 for more information on SSN disclosure and verification requirements.)**

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10. *Advise the family that HUD will compare the information supplied with information federal, state, or local agencies have on the family's income and household composition. *This will include the employment and income information received from SSA's and HHS' NDNH databases through HUD's Computer Matching Agreements with these agencies.**
11. *Tell the family that a final decision on eligibility cannot be made until all verifications are complete.*
12. *Provide each *applicant* with a copy of the appropriate HUD fact sheet, which describes how the tenant's rent is calculated.*
13. **Provide each household with copies of the EIV & You and the Resident Rights and Responsibilities brochures.**

14. *Inform the family that federal laws prohibit the owner from discriminating against individuals with disabilities. In summary, owners have responsibilities for making reasonable accommodations in policies, providing auxiliary aids, making units and facilities accessible, and permitting disabled persons to use assistance animals when they may provide the tenant with equal housing opportunities.*
15. *Inform all applicants of housing for the elderly or disabled about the rules on owning pets. (See paragraph 6-10.)*

C. *Generally, owners may not require tenants to participate in congregate meals or other services. However, in properties for the elderly or disabled for which HUD approved a mandatory meals program before April 1, 1987, the owner must inform all applicants about:*
   1. *The requirement to execute a meals contract. A meal contract is a separate contract incorporated as part of the lease that states in part:*
      a. *Substantial failure by a tenant to comply with the mandatory meals agreement will be a violation of the lease and will subject the tenant to eviction procedures in accordance with the lease;*
      b. *The number of meals required to be purchased;*
      c. *The duration of the meals agreement;*
      d. *The charges for the meals at the time the agreement is signed; and*
      e. *The exemptions from purchasing meals and the requirements to obtain these exemptions.*
   2. *Exemptions from purchasing meals may be made due to:*
      a. *Medical conditions;*
      b. *A paying job that keeps the tenant away from the property at meal time;*
      c. *Other absence from the property;*
      d. *Permanent immobility; and/or*
      e. *Discretionary exemptions, such as dietary practices, financial reasons, or religious reasons.*

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e. Select a sample of tenant files. The sample should include some recently admitted tenants as well as some tenants who no longer reside at the project. The requirements below are covered in HUD Handbook 4350.3. The auditor should review the Handbook to determine whether requirements have been added or removed to ensure completeness of review in this area. Perform a minimum of the following steps, as applicable:

(1) Determine whether all appropriate parties signed the application.

(2) Determine whether household members were correctly identified and the head, cohead, and all tenants age 18 and older signed the applicant's/tenant's consent to the release of information, Form HUD 9887-A.

(3) Determine whether the owner/management agent verified Social Security numbers of all occupants six years of age and older, disability status, waiting list preferences, and income and allowances for adjusted income (refer to Handbook 4350.3, appendix 3, for additional information on acceptable form of verification).

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E. Income Limits and Family Size
   1. *Income limits vary by family size. Income limits are published based on the number of persons in the household (for example, 1 person, 2 persons, 3 persons) with increasingly higher income limits for families with more members.*
   2. *Once the owner determines the applicable income limits based on the type of subsidy in the property, the owner must determine the appropriate limits to apply to a family based on family size. In determining the appropriate income limits, the owner must include some individuals as part of the family but exclude others.*
   3. *When determining family size for establishing income eligibility, the owner must include all persons living in the unit except the following:*

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a. Live-in aide.

1) *A person who resides with one or more elderly persons, near-elderly persons, or persons with disabilities, and who:*
   a) *Is determined to be essential to the care and wellbeing of the person(s);*
   b) *Is not obligated for the support of the person(s); and*
   c) *Would not be living in the unit except to provide the necessary supportive services.*
2) *To qualify as a live-in aide:*
   a. *The owner must verify the need for the live-in aide. Verification that the live-in aide is needed to provide the necessary supportive services essential to the care and well-being of the person must be obtained from the person's physician, psychiatrist or other medical practitioner or health care provider. The owner must approve a live-in aide if needed as a reasonable accommodation in accordance with 24 CFR Part 8 to make the program accessible to and usable by the family member with a disability. The owner may verify whether the live-in aide is necessary only to the extent necessary to document that applicants or tenants who have requested a live-in aide have a disability-related need for the requested accommodation. This may include verification from the person's physician, psychiatrist or other medical practitioner or health care provider. The owner may not require applicants or tenants to provide access to confidential medical records or to submit to a physical examination. (See discussion in Chapter 2.)*
   b. *Expenses for services provided by the live-in aide, such as nursing services (dispensing of medications or providing other medical needs) and personal care (such as bathing or dressing), that are out-of-pocket expenses for the tenant and where the tenant is not reimbursed for the expenses from other sources, are considered as eligible medical expenses. Homemaker services such as housekeeping and meal preparation are not eligible medical expenses. (See Chapter 5 and Exhibit 5-3 for more information on medical expenses.)*

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   c. *Qualifies for occupancy only as long as the individual needing supportive services requires the aide's services and remains a tenant. The live-in aide may not qualify for continued occupancy as a remaining family member. Owners are encouraged to use a HUD-approved lease addendum that denies occupancy of the unit to a live-in aide after the tenant, for whatever reason, is no longer living in the unit. (See paragraph 6-5.A.4.g for more information.) The lease addendum should also give the owner the right to evict a live-in aide who violates any of the house rules.*
   d. *Income of a live-in aide is excluded from annual income. (See Exhibit 5-1.)*
   e. **Must disclose and provide verification of their SSN.**
   f. *Must meet the screening criteria discussed in Paragraph 4-7 B.5.*
3) *A relative may be considered to be a live-in aide if they meet the requirements in 1, above, especially 1(c).*
4) *An adult child is eligible to move into a Section 202/8 project after initial occupancy only if they are essential to the care or well-being of the elderly parent(s). The adult child may be considered a live-in aide if all of the requirements in 1, above, apply and there is a verified need for a live-in aide in accordance with 2(a), above. (See Paragraph 7-4.D for more discussion on adult children moving in after initial occupancy.)*
5) *An adult child is not eligible to move into a Section 202 PRAC or Section 811 PRAC after initial occupancy unless they are performing the functions of a live-in aide and are eligible to be classified as a live-in aide for eligibility purposes. (See Paragraph 7-4.E.)*

b. Guests. (See the Glossary for the definition.)

4. *When determining family size for income limits, the owner must include the following individuals who are not living in the unit:*
   a. *Children temporarily absent due to placement in a foster home;*
   b. *Children in joint custody arrangements who are present in the household 50% or more of the time;*
   c. *Children who are away at school but who live with the family during school recesses;*
   d. *Unborn children of pregnant women.*
   e. *Children who are in the process of being adopted.*

f. Temporarily absent family members who are still considered family members. For example, the owner may consider a family member who is working in another state on assignment to be temporarily absent;
g. Family members in the hospital or rehabilitation facility for periods of limited or fixed duration. These persons are temporarily absent as defined in subparagraph f above; and
h. Persons permanently confined to a hospital or nursing home. The family decides if such persons are included when determining family size for income limits. If such persons are included, they must not be listed as the head, co-head, or spouse on the lease or in the data submitted to TRACS but may be listed as other adult family member. This is true even when the confined person is the spouse of the person who is or will become the head. If the family chooses to include the permanently confined person as a member of the household, the owner must include income received by these persons in calculating family income. See paragraph 5-6.D.

5. When determining income eligibility, the owner must count the income of family members only.

3-9 Disclosure of Social Security Numbers

All applicant and tenant household members must disclose and provide verification of the complete and accurate SSN assigned to them except for those individuals who do not contend eligible immigration status or tenants who were age 62 or older as of January 31, 2010, and whose initial determination of eligibility was begun before January 31, 2010. This paragraph explains the requirements and responsibilities of applicants or tenants to supply owners with this information, the responsibility of owners to obtain this information, and the consequences for failure to provide the information.

A. Key Requirements

*1. *Applicants and tenants must disclose and provide verification of the complete and accurate SSN assigned to each household member. Failure to disclose and provide documentation and verification of SSNs will result in an applicant not being admitted or a tenant household's tenancy being terminated.*
2. Exceptions to disclosure of SSN:
a. Individuals who do not contend eligible immigration status.
1) Mixed Families: For projects where the restriction on assistance to noncitizens applies and where individuals are required to declare their citizenship status, proration of assistance or screening for mixed families must continue to be followed. In these instances, the owner will have the tenant's Citizenship Declaration on file whereby the individual did not contend eligible immigration status to support the individual not being subject to the requirements to disclose and provide verification of a SSN.

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2) For Section 221(d)(3) BMIR, Section 202 PAC, Section 202 PRAC and Section 811 PRAC properties, the restriction on providing assistance to noncitizens does not apply. At these properties, individuals who do not contend eligible immigration status must sign a certification, containing the penalty of perjury clause, certifying to that effect. The certification will support the individual not being subject to the requirements to disclose or provide verification of a SSN. The certification must be retained in the tenant file. (See Paragraphs 3-12.N, O and P for more information on mixed families and proration of assistance)
b. Individuals age 62 or older as of January 31, 2010, whose initial determination of eligibility was begun before January 31, 2010.
1) The exception status for these individuals is retained even if there is a break in his or her participation in a HUD assisted program.
*2) When determining the eligibility of an individual who meets the exception requirements for SSN disclosure and verification, documentation must be obtained that verifies the applicant's exemption status. A certification from the tenant is not acceptable verification of the exemption status. This documentation must be retained in the tenant file.*B.*

B. Required Documentation

**Applicants and tenants must provide adequate documentation to verify the complete and accurate SSNs assigned to all household members. Adequate documentation means a social security card issued by the Social Security Administration (SSA), an original document issued by a federal or state government agency, which contains the name and SSN of the individual along with*

*identifying information of the individual, or other acceptable evidence of the SSN listed in Appendix 3. **

C. *Provisions for *Applicants Disclosure and/or* Documentation of Social Security Numbers*
An applicant may not be admitted until SSNs for all household members have been disclosed and verification provided.

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1. *If all household members have not disclosed and/or provided verification of their SSNs at the time a unit becomes available, the next eligible applicant must be offered the available unit.*
2. *The applicant who has not disclosed and provided verification of SSNs for all household members must disclose and provide verification of SSNs for all household members to the owner within 90 days from the date they are first offered an available unit.**
3. *If the owner has determined that the applicant is otherwise eligible for admission into the property, and the only outstanding verification is that of *disclosing and providing verification of* the SSN, the applicant may retain his or her place on the waiting list for the *90*-day period during which the applicant is trying to obtain documentation.*
4. *After *90* days, if the applicant has been unable to supply the required SSN *and verification* documentation, the applicant should be determined ineligible and removed from the waiting list (see paragraph 4-20 A).*

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F. *Owners may verify a person's disability but must adhere to certain verification guidelines.*

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1. *The owner may verify a person's disability only to the extent necessary to document that applicants:*
   a. *Are qualified for the housing for which they are applying **(see Figure 3-5 on determining project eligibility and Figure 3-6 for applicable disability definitions by program type):***
   b. *Are qualified for deductions used in determining adjusted income;*
   c. *Are entitled to any preference they may claim;*
   d. *Who have requested a reasonable accommodation have a disability-related need for the requested accommodation or modification; and*
   e. *Need the design features of the unit.*
2. *Owners may not require applicants to provide access to confidential medical records in order to verify a disability.*
3. *Additional information on verifying eligibility of persons with disabilities can be found in paragraph **3-28** B and in **Appendix 6**.*

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*Housing Preferences **(4-6)***

- *Preferences affect place on waiting list not eligibility. (People with preferences get housing sooner than no preferences)*
- *Mandatory and Conditional*
- *All applicants must be informed of preferences and be given a chance to qualify*

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*Housing Preferences **(4-6)***

- *Statutory – 221(d)(4), 221(d)(3) and 221(d)(3)BMIR must give preference to displaced persons*
- *HUD – 236 properties prefer displaced persons*

Displacement refers to government action or declared disasters.

C. *Owner-Adopted Preferences*
Owners are permitted to establish other preferences for assisted properties as long as they are subordinate to any program-specific preferences discussed in subparagraph B above, and comply with applicable fair housing and civil rights statutes. Some of these owner-adopted preferences require prior HUD approval (as noted below) and some do not. The types of preferences that may be implemented by owners to serve unique groups of needy applicants include:

1. *<u>Residency preferences.</u> A residency preference provides applicants who live in a specific geographic area at the time of application a priority over nonresidents.*

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a. *Owners must never adopt a residency requirement (meaning the owner will not lease to any applicant who does not live in the defined jurisdiction or municipality).*
b. *A residency preference *must be developed, implemented, and executed in accordance with the non-discrimination and equal opportunity requirements listed at 24 CFR 5.105(a).**
c. *HUD must approve residency preferences prior to use by the owner. HUD will approve residency preferences only if the preference does not result in discrimination or violate equal opportunity requirements.*
d. *When an owner adopts residency preferences, HUD requires that the owner consider the following as residents:*
   1) *Applicants who work in the jurisdiction;*
   2) *Applicants who have been hired to work in the jurisdiction; or*
   3) *Applicants who are expected to live in the jurisdiction as a result of planned employment.*

   ***NOTE:** "Planned employment" means bona fide offer to work in a municipality.*

e. *The owner **may** treat graduates of, or active participants in, education and training programs located in a residency preference area as residents of the area if the education or training program is designed to prepare individuals for the job market.*
f. *For Section 8 properties, an owner's residency preference must be approved by HUD through a modification to the Affirmative Fair Housing Marketing Plan, in accordance with 24 CFR 108.*
g. *Owners may not base a residency preference on the length of time an applicant has lived or worked in the area.*
h. *If there are no eligible residents on the waiting list, owners cannot hold units open because of a residency preference. In this situation, owners must admit the next household on the waiting list.*

2. *<u>Working families.</u> Owners may adopt a preference in selecting families from the waiting list for those families in which the head of household or spouse is employed. Even if the owner adopts such a preference, however, discrimination against persons unable to work is prohibited. Owners must not deny the preference to households in which the head or spouse is 62 or older, or to a person with disabilities.*
3. *<u>Disability.</u> Owners may adopt a preference to select families that include a person with a disability. Owners may not create preferences for persons with a specific type of disability unless allowed in the controlling documents for the property. (See Chapter 3, Section 2.) Owners may not apply a preference for persons without disabilities.*
4. *<u>Victims of Domestic Violence, *Dating Violence or Stalking*.</u> Owners may adopt a preference for admission of families that include victims of domestic violence, *dating violence or stalking*.*
5. *<u>Specific groups of single persons.</u> Owners may adopt a preference for single persons who are elderly, displaced, homeless or persons with disabilities over other single persons.*

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Figure 5-2: Whose Income is Counted?

Members	Employment Income	Other Income (including income from assets)
Head	Yes	Yes
Spouse	Yes	Yes
Co-head	Yes	Yes
Other adult (including foster adult)	Yes	Yes
Dependents		
-Child under 18	No	Yes
Full-time student over 18	See Note	Yes
Foster child under 18	No	Yes
Nonmembers		
Live-in aide	No	No

NOTE: The earned income of a full-time student 18 years old or older who is a dependent is excluded to the extent that it exceeds $480.

2. *Adults. Count the annual income of the head, spouse or co-head, and other adult members of the family. In addition, persons under the age of 18 who have entered into a lease under state law are treated as adults, and their annual income must also be counted. These persons will be either the head, spouse, or co-head; they are sometimes referred to as emancipated minors.*

   ***NOTE**: If an emancipated minor is residing with a family as a member other than the head, spouse, or co-head, the individual would be considered a dependent and his or her income handled in accordance with subparagraph 3 below.*

3. *Dependents. A dependent is a family member who is under 18 years of age, is disabled, or is a full-time student*

   The head of the family, spouse, co-head, foster child, or live-in aide are never dependents. Some income received on behalf of family dependents is counted and some is not.

   a. *Earned income of minors (family members under 18) <u>is not</u> counted.*
   b. *Benefits or other unearned income of minors <u>is</u> counted.*
   c. *When more than one family shares custody of a child, and both families live in assisted housing, only one family at a time can claim the dependent deduction. The family that counts the dependent deduction also counts the unearned income of the child. The other family claims neither the dependent deduction nor the unearned income of the child.*
   d. *For full-time students, who are 18 years of age or older *and* are dependents, a small amount of their earned income will be counted. Count only earned income up to a maximum of $480 per year for full-time students, age 18 or older, who are not the head of the family; spouse or co-head.*If the earned income is less than $480 annually, count all of the income. If the earned income exceeds $480 annually,* count $480 and exclude the amount that exceeds $480.*
   e. *The income of full-time students 18 years of age or older who are members of the household but away at school is counted the same as the income for other full-time students. The income of minors who are members of the household but away at school is counted as the income for other minors.*

f. *All income of a full-time student, 18 years of age or older, is counted if that person is the head of the family, spouse, or cohead.*
g. *Payments received by the family for the care of foster children or foster adults are not counted. This rule applies only to payments made through the official foster care relationships with local welfare agencies.*
h. *Adoption assistance payments in excess of $480 are not counted.*

5-5 Methods for Projecting and Calculating Annual Income

A. *The requirements for determining whether a family is eligible for assistance, and the amount of rent the family will pay, require the owner to project or estimate the annual income that the family expects to receive. There are several ways to make this projection. The following are acceptable methods for calculating the annual income anticipated for the coming year:*

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1. *Generally the owner must use current circumstances to anticipate income. The owner calculates projected annual income by annualizing current income. Income that may not last for a full 12 months (e.g., unemployment compensation) should be calculated assuming current circumstances will last a full 12 months. If changes occur later in the year, an interim recertification can be conducted to change the family's rent.*
2. *If information is available on changes expected to occur during the year, use that information to determine the total anticipated income from all known sources during the year.*
3. **Using EIV:*
   a. *The owner must not use the quarterly wage income reported on the EIV Income Report for calculating the tenant's annual income from employment. The owner must confirm with the tenant that the information in EIV is correct. If the tenant agrees that the employment information reported in EIV is correct, the owner must:*

      1) *Use the Income Report as third party verification of the tenant's employment; and*
      2) *Use tenant provided documents for calculating the tenant's annual income, e.g. 4-6 current, consecutive check stubs.*

   b. *The owner must not use the quarterly unemployment compensation benefits reported on the EIV Income Report for calculating the tenant's annual income from unemployment. The owner must confirm with the tenant that the unemployment information in EIV is correct. If the tenant agrees that he/she is receiving unemployment compensation benefits as reported in EIV, the owner must:*
      1) *Use the Income Report as third party verification that the tenant is receiving unemployment; and*
      2) *Use tenant provided documents for calculating annual income, e.g. unemployment monetary benefit notice.*
   c. *If the tenant agrees with the social security benefit information on the EIV Income Report, the owner must use the EIV Income Report as third party verification, receiving social security benefits and also for calculating the tenant's annual income.*
   d. *If the tenant disputes the employment and income information in EIV, the owner must obtain third party verification from the source.**

B. *Once all sources of income are known and verified, owners must convert reported income to an annual figure. Convert periodic wages to annual income by multiplying:*
   1. *Hourly wages by the number of hours worked per year (2,080 hours for full-time employment with a 40-hour week and no overtime);*
   2. *Weekly wages by 52;*
   3. *Bi-weekly wages (paid every other week) by 26;*
   4. *Semi-monthly wages (paid twice each month) by 24; and*
   5. *Monthly wages by 12.*

   To annualize other than full-time income, multiply the wages by the actual number of hours or weeks the person is expected to work.

C. *Some circumstances present more than the usual challenges to estimating anticipated income. Examples of challenging situations include a family that has sporadic work or seasonal income or*

a tenant who is self-employed. In all instances, owners are expected to make a reasonable judgment as to the most reliable approach to estimating what the tenant will receive during the year. In many of these challenging situations, midyear or interim recertifications may be required to reflect changing circumstances. Some examples of approaches to more complex situations are provided below.

Exhibit 5-1: Income Inclusions and Exclusions

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24 CFR 5.609(b) and (c)

Examples included in parentheses have been added to the regulatory language for clarification.

INCOME INCLUSIONS

(1) The full amount, before any payroll deductions, of wages and salaries, overtime pay, commissions, fees, tips and bonuses, and other compensation for personal services;

(2) The net income from operation of a business or profession. Expenditures for business expansion or amortization of capital indebtedness shall not be used as deductions in determining net income. An allowance for depreciation of assets used in a business or profession may be deducted, based on straight line depreciation, as provided in Internal Revenue Service regulations. Any withdrawal of cash or assets from the operation of a business or profession will be included in income, except to the extent the withdrawal is reimbursement of cash or assets invested in the operation by the family;

(3) Interest, dividends, and other net income of any kind from real or personal property. Expenditures for amortization of capital indebtedness shall not be used as deductions in determining net income. An allowance for depreciation is permitted only as authorized in paragraph (2) above. Any withdrawal of cash or assets from an investment will be included in income, except to the extent the withdrawal is reimbursement of cash or assets invested by the family. Where the family has net family assets in excess of $5,000, annual income shall include the greater of the actual income derived from all net family assets or a percentage of the value of such assets based on the current passbook savings rate, as determined by HUD;

(4) The full amount of periodic amounts received from social security, annuities, insurance policies, retirement funds, pensions, disability or death benefits, and other similar types of periodic receipts, including a lump-sum amount or prospective monthly amounts for the delayed start of a **periodic amount (e.g., Black Lung Sick benefits, Veterans Disability, Dependent Indemnity Compensation, payments to the widow of a serviceman killed in action). See paragraph (13) under Income Exclusions for an exception to this paragraph;**

(5) Payments in lieu of earnings, such as unemployment, disability compensation, worker's compensation, and severance pay, except as provided in paragraph (3) under Income Exclusions;

(6) Welfare Assistance.

(a) Welfare assistance received by the family.

(b) If the welfare assistance payment includes an amount specifically designated for shelter and utilities that is subject to adjustment by the welfare assistance agency in accordance with the actual cost of shelter and utilities. the amount of welfare assistance income to be included as

income shall consist of:

(c) The amount of the allowance or grant exclusive of the amount specifically designated for shelter or utilities; plus

(d) The maximum amount that the welfare assistance agency could in fact allow the family for shelter and utilities. If the family's welfare assistance is ratably reduced from the standard of need by applying a percentage, the amount calculated under this paragraph shall be the amount resulting from one application of the percentage.

(7) Periodic and determinable allowances, such as alimony and child support payments, and regularr contributions or gifts received from organizations or from persons not residing in the dwelling; and

(8) All regular pay, special pay, and allowances of a member of the Armed Forces, except as provided in paragraph (7) under Income Exclusions.

(9) For Section 8 programs only and as provided in 24 CFR 5.612, any financial assistance, in excess of amounts received for tuition, that an individual receives under the Higher Education Act of 1965 (20 U.S.C. 1001 *et seq.)*, from private sources, or from an institution of higher education (as defined under the Higher Education Act of 1965 (20 U.S.C. 1002)), shall be considered income to that individual, except that financial assistance described in this paragraph is not considered annual income for persons over the age of 23 with dependent children. For purposes of this paragraph "financial assistance" does not include loan proceeds for the purpose of determining income. *(Note: This paragraph also does not apply to a student who is living with his/her parents who are applying for or receiving Section 8 assistance.)*

INCOME EXLCUSIONS:

(1) Income from employment of children (including foster children) under the age of 18 years;

(2) Payments received for the care of foster children or foster adults (usually persons with disabilities unrelated to the tenant family, who are unable to live alone);

(3) Lump-sum additions to family assets, such as inheritances, insurance payments (including payments under health and accident insurance and worker's compensation), capital gains, and settlement for personal or property losses, except as provided in paragraph (5) under Income Inclusions;

(4) Amounts received by the family that are specifically for, or in reimbursement of, the cost of medical expenses for any family member;

(5) Income of a live-in aide, as defined in 24 CFR 5.403;

(6) The full amount of student financial assistance paid directly to the student or to the educational institution (see Income Inclusions (9), above, for students receiving Section 8 assistance);

(7) The special pay to a family member serving in the Armed Forces who is exposed to hostile fire (e.g., in the past, special pay included Operation Desert Storm);

(8) (a) Amounts received under training programs funded by HUD (e.g., training received under Section 3);

(b) Amounts received by a person with a disability that are disregarded for a limited time for purposes of supplemental security income eligibility and benefits because they are set-aside for use under a Plan to Attain Self-Sufficiency (PASS);

(c) Amounts received by a participant in other publicly assisted programs that are specifically for or in reimbursement of out-of-pocket expenses incurred (special equipment, clothing, transportation, child care, etc.) and which are made solely to allow participation in a specific program;

(d) Amounts received under a resident service stipend. A resident service stipend is a modest amount (not to exceed $200 per month) received by a resident for performing a service for the owner, on a part-time basis, that enhances the quality of life in the project. Such services may include, but are not limited to, fire patrol, hall monitoring, lawn maintenance, and resident-initiative coordination. No resident may receive more than one such stipend during the same period of time; or

(e) Incremental earnings and benefits resulting to any family member from participation in qualifying state or local employment training programs (including training programs not affiliated with a local government) and training of a family member as a resident management staff person. Amounts excluded by this provision must be received under employment training programs with clearly defined goals and objectives, and are excluded only for the period during which the family member participates in the employment training program.

(9) Temporary, nonrecurring, or sporadic income (including gifts);

(10) Reparation payments paid by a foreign government pursuant to claims filed under the laws of that government by persons who were persecuted during the Nazi era. (Examples include payments by the German and Japanese governments for atrocities committed during the Nazi era);

(11) Earnings in excess of $480 for each full-time student 18 years or older (excluding the head of household and spouse);

(12) Adoption assistance payments in excess of $480 per adopted child;

(13) Deferred periodic amounts from supplemental security income and social security benefits that are received in a lump-sum amount or in prospective monthly amounts;

(14) Amounts received by the family in the form of refunds or rebates under state or local law for property taxes paid on the dwelling unit;

(15) Amounts paid by a state agency to a family with a member who has a developmental disability and is living at home to offset the cost of services and equipment needed to keep the developmentally disabled family member at home; or

(16) Amounts specifically excluded by any other federal statute from consideration as income for purposes of determining eligibility or benefits under a category of assistance programs that includes assistance under any program to which the exclusions set forth in 24 CFR 5.609(c) apply. A notice will be published in the *Federal Register* and distributed to housing owners identifying the benefits that qualify for this exclusion. Updates will be published and distributed when necessary.

The following is a list of income sources that qualify for that exclusion:

(a) The value of the allotment provided to an eligible household under the Food Stamp Act of 1977 (7 U.S.C. 2017 [b]);

(b) Payments to Volunteers under the Domestic Volunteer Services Act of 1973 (42 U.S.C. 5044(g), 5058) (employment through AmeriCorps, Volunteers in Service to America [VISTA], Retired Senior Volunteer Program, Foster Grandparents Program, youthful offender incarceration alternatives, senior companions);

(c) Payments received under the Alaska Native Claims Settlement Act (43 U.S.C. 1626[c])

(d) Income derived from certain submarginal land of the United States that is held in trust for certain Indian tribes (25 U.S.C. 459e);

(e) Payments or allowances made under the Department of Health and Human Services' Low-Income Home Energy Assistance Program (42 U.S.C. 8624[f]);

(f) Payments received under programs funded in whole or in part under the Job Training Partnership Act (29 U.S.C. 1552[b]; (effective July 1, 2000, references to Job Training Partnership Act shall be deemed to refer to the corresponding provision of the Workforce Investment Act of 1998 [29 U.S.C. 2931], e.g., employment and training programs for Native Americans and migrant and seasonal farm workers, Job Corps, veterans employment programs, state job training programs, career intern programs, Americorps);

(g) Income derived from the disposition of funds to the Grand River Band of Ottawa Indians (Pub. L-94-540, 90 Stat. 2503-04);

(h) The first $2,000 of per capita shares received from judgment funds awarded by the Indian Claims Commission or the U. S. Claims Court and the interests of individual Indians in trust or restricted lands, including the first $2,000 per year of income received by individual Indians from funds derived from interests held in such trust or restricted lands (25 U.S.C. 1407-1408);

(i) Amounts of scholarships funded under title IV of the Higher Education Act of 1965, including awards under federal work-study programs or under the Bureau of Indian Affairs student assistance programs (20 U.S.C. 1087uu);

(j) Payments received from programs funded under Title V of the Older Americans Act of 1985 (42 U.S.C. 3056[f]), e.g., Green Thumb, Senior Aides, Older American Community Service Employment Program;

(k) Payments received on or after January 1, 1989, from the Agent Orange Settlement Fund or any other fund established pursuant to the settlement in *In Re Agent*-product liability litigation, M.D.L. No. 381 (E.D.N.Y.);

(l) Payments received under the Maine Indian Claims Settlement Act of 1980 (25 U.S.C. 1721);

(m) The value of any child care provided or arranged (or any amount received as payment for such care or reimbursement for costs incurred for such care) under the Child Care and Development Block Grant Act of 1990 (42 U.S.C. 9858q);

(n) Earned income tax credit (EITC) refund payments received on or after January 1, 1991, including advanced earned income credit payments (26 U.S.C. 32[j]);

(o) Payments by the Indian Claims Commission to the Confederated Tribes and Bands of Yakima Indian Nation or the Apache Tribe of Mescalero Reservation (Pub. L. 95-433);

(p) Allowances, earnings, and payments to AmeriCorps participants under the National and Community Service Act of 1990 (42 U.S.C. 12637[d]);

(q) Any allowance paid under the provisions of 38 U.S.C. 1805 to a child suffering from spina bifida who is the child of a Vietnam veteran (38 U.S.C. 1805);

(r) Any amount of crime victim compensation (under the Victims of Crime Act) received through crime victim assistance (or payment or reimbursement of the cost of such assistance) as determined under the Victims of Crime Act because of the commission of a crime against the applicant under the Victims of Crime Act (42 U.S.C. 10602); and

(s) Allowances, earnings and payments to individuals participating in programs under the Workforce Investment Act of 1998 (29 U.S.C. 2931).

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(4) Determine whether the resident rights and responsibilities were acknowledged.
AHACPA Comment – this is accomplished by delivering to the tenant the HUD Rights and Responsibilities Brochure.

(5) Determine whether citizenship declaration or eligible immigrant status was obtained.
(6) Determine whether all adult tenants were screened for criminal and drug background checks as well as sex offender registration.
(7) Determine whether the correct HUD model lease and addendums were used and correctly signed/executed.
(8) Determine whether the appropriate security deposit and prorated rent were correctly calculated and collected.
(9) Determine whether the appropriate security deposit and prepaid rent were returned within 30 days after move-out.
(10) Determine whether the owner's certification of compliance with HUD's tenant eligibility and rent procedures, Form HUD-50059, was completed correctly.

4350.3 Citizenship Requirements (page 3-20)

B. ***Key Requirements***

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1. *Assistance in subsidized housing is restricted to the following:*
   a. *U.S. citizens or nationals; and*
   b. *Noncitizens that have eligible immigration status.*
2. *All applicants for assistance must be given notice of the requirement to submit evidence of citizenship or eligible immigration status at the time of application. The entity responsible for receiving the documentation, where possible, must arrange to provide the notice in a language that is understood by the individual if the person is not proficient in English. (See Exhibits 3-3 and 3-4 for a sample notice and its accompanying Family Summary Sheet.)*
3. *All family members, regardless of age, must declare their citizenship or immigration status. (See Exhibit 3-5 for a Sample Citizenship Declaration. Noncitizens (except those age 62 and older) must sign a Verification Consent Form (see Sample Verification Consent Form in Exhibit 3-6) and submit documentation of their status or sign a declaration that they do not claim to have eligible status. Noncitizens age 62 and older must sign a declaration of eligible immigration status and provide a proof of age document. U.S. citizens must sign a declaration of citizenship. Owners may establish a policy of requiring additional proof of citizenship for those declaring to be U.S. citizens or nationals.*
4. *A mixed family—a family with one or more ineligible family members and one or more eligible family members—may receive prorated assistance, continued assistance, or a temporary deferral of termination of assistance. See subparagraphs O, P and Q below for the requirements that must be met for a mixed family to be eligible for assistance.*

5. *Applicants who hold a noncitizen student visa are ineligible for assistance, as are any noncitizen family members living with the student. For noncitizen students with a citizen spouse or citizen children, see the rules in paragraph 3-12 R.2 below.*

I. ***Required Documentation of Citizenship/Immigration Status***

1. *The owner must obtain the following documentation for each family member regardless of age:*
   a. *From U.S. citizens, a signed declaration of citizenship. Owners may require verification of the declaration by requiring presentation of a U.S. birth certificate or U.S. passport.*
   b. *From noncitizens 62 years and older, a signed declaration of eligible noncitizen status and proof of age;*
   c. *From noncitizens under the age of 62 claiming eligible status:*
      1) *A signed declaration of eligible immigration status;*
      2) *A signed consent form; and*
2. *One of the DHS-approved documents listed in Figure 3-4.Noncitizens not claiming eligible immigration status may elect to sign a statement that they acknowledge their ineligibility for*

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Figure 3-4: Acceptable DHS Documents

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- Form I-551, **Permanent Resident Card**.
- Form 1-94, *Arrival-Departure Record* annotated with one of the following:
  - "Admitted as a Refugee Pursuant to Section 207";
  - "Section 208" or "Asylum";
  - "Section 243(h)" or "Deportation stayed by Attorney General"; or
  - "Paroled Pursuant to Section 212(d)(5) of the INA."
- Form I-94, *Arrival-Departure Record* (with no annotation) accompanied by one of the following:
  - A final court decision granting asylum (but only if no appeal is taken);
  - A letter from an DHS asylum officer granting asylum (if application was filed on or after October 1, 1990) or from an DHS district director granting asylum (application filed was before October 1, 1990);
  - A court decision granting withholding of deportation; or
  - A letter from an asylum officer granting withholding of deportation (if application was filed on or after October 1, 1990).
- A receipt issued by the DHS indicating that an application for issuance of a replacement document in one of the above-listed categories has been made and that the applicant's entitlement to the document has been verified.
- Other acceptable evidence. If other documents are determined by the DHS to constitute acceptable evidence of eligible immigration status, they will be announced by notice published in the *Federal Register*.

*assistance. *This statement is in addition to their declaring their citizenship status on the Citizenship Declaration form (see Exhibit 3-5).**

4-7 Screening for Suitability

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Screening is used to help ensure that families admitted to a property will abide by the terms of the lease, pay rent on time, take care of the property and unit, and allow all residents to peacefully enjoy their homes. Information collected through the screening process enables owners to make informed and objective decisions to admit applicants who are most likely to comply with the terms of the lease. An effective screening policy will also ensure fair, consistent, and equal treatment of applicants. All screening criteria adopted by the owner must be described in the tenant selection plan and consistently applied to all applicants in a non-discriminatory fashion and in accordance with all applicable fair housing and civil rights laws.

C. ***Screening For Drug Abuse and Other Criminal Activity***

1. *Tenant selection plans must contain screening criteria that include standards for prohibiting admission of those who have engaged in drug related or criminal activity. The plan may, under certain circumstances, include additional provisions that deny admission to applicants for other drug and criminal activity.*
2. *Owners must establish standards that prohibit admission of:*

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   a. *Any household containing a member(s) who was evicted in the last three years from federally assisted housing for drug-related criminal activity. The owner may, but is not required to, consider two exceptions to this provision:*
      1) *The evicted household member has successfully completed an approved, supervised drug rehabilitation program; or*
      2) *The circumstances leading to the eviction no longer exist (e.g., the household member no longer resides with the applicant household).*
   b. *A household in which any member is currently engaged in illegal use of drugs or for which the owner has reasonable cause to believe that a member's illegal use or pattern of illegal use of a drug may interfere with the health, safety, and right to peaceful enjoyment of the property by other residents;*
   c. *Any household member who is subject to a State sex offender lifetime registration requirement; and*
   d. *Any household member if there is reasonable cause to believe that member's behavior, from abuse or pattern of abuse of alcohol, may interfere with the health, safety, and right to peaceful enjoyment by other residents. The screening standards must be based on behavior, not the condition of alcoholism or alcohol abuse.*
3. *Owners may establish additional standards that prohibit admission if the owner determines that any household member is currently engaging in, or has engaged in, the following activities during a reasonable time before the admission decision:*
   a. *Drug-related criminal activity. The owner may include additional standards beyond the required standards that prohibit admission in the case of eviction from federally assisted housing for drug related criminal activity and current drug use.*
   b. *Violent criminal activity.*
   c. *Other criminal activity that threatens the health, safety, and right to peaceful enjoyment of the property by other residents or the health and safety of the owner, employees, contractors, subcontractors, or agents of the owner.*

***NOTE:**. If an owner's admission policy includes any of the activities above or similar restrictions that uses a standard regarding a household member's current or recent actions, the owner may define the length of time prior to the admission decision during which the applicant must not have engaged in the criminal activity. The owner shall ensure that the relevant "reasonable" time period is uniformly applied to all applicants in a non-discriminatory manner and in accordance with applicable fair housing and civil rights laws.*

F. ***Permitted Screening Criteria Commonly Used by Owners***

1. *Overview. Owners are permitted to screen applicants for suitability to help them to determine whether to accept or deny an applicant's tenancy. Owners should consider at least developing screening criteria related to the following factors and may establish other criteria not specifically prohibited in paragraph 4-8 below. All screening criteria adopted by the owner must be described in the tenant selection plan and consistently applied to all applicants.*
2. *Screening for credit history. Examining an applicant's credit history is one of the most common screening activities. The purpose of reviewing an applicant's credit history is to determine how well applicants meet their financial obligations. A credit check can help demonstrate whether an applicant has the ability to pay rent on time.*
   a. *Owners may reject an applicant for a poor credit history, but a lack of credit history is not sufficient grounds to reject an applicant.*
   b. *As part of their written screening criteria, and in order to ensure that all applicants are treated fairly, owners should describe the general criteria they will use for distinguishing between an acceptable and unacceptable credit rating. Owners are most often interested in an applicant's credit history related to rent and utility payments. A requirement for applicants to have a perfect credit rating is generally too strict a standard.*
   c. *Owners may determine how far back to consider an applicant's credit history. Owners generally focus on credit activity for the past three to five years. It is a good management practice to give priority to current activity over older activity.*
   d. *Owners may have to justify the basis for a determination to deny tenancy because of the applicant's credit rating, so there should be a sound basis for the rejection.*
3. *Minimum Income Requirement. Section 236 and Section 221(d)(3) BMIR applicants who receive no other form of assistance, such as Section 8, may be screened for the ability to pay the Section 236 basic rent or the BMIR rent. Owners may establish a reasonable minimum income requirement to assess the applicant's ability to pay the rent. In the Section 8, RAP, and Rent Supplement programs, owners may* ***not*** *establish a minimum income requirement for applicants. (See paragraph 4-8.A.)*
4. *Screening for rental history. In addition to determining whether applicants are likely to meet their financial obligations as tenants and pay rent on time, owners are also interested in whether applicants have the ability to meet the requirements of tenancy.*
   a. *Owners must not reject an applicant for lack of a rental history but may reject an applicant for a poor rental history.*
   b. *As part of their written screening criteria, and in order to ensure that all applicants are treated fairly, owners should describe the general criteria they will use for distinguishing between acceptable and unacceptable rental history.*
5. *Screening for housekeeping habits. Owners may visit the applicant's current dwelling to assess housekeeping habits.*
   a. *As part of their written screening criteria, and in order to ensure that all applicants are treated fairly, owners should describe the general criteria they will use for distinguishing between acceptable and unacceptable housekeeping practices.*
   b. *Owners must establish reasonable standards which can be consistently applied to all families. Messy living quarters are not the same as safety and health hazards.*
   c. *In defining the home visit standards, the owner should establish a geographic radius within which home visits are made, and outside of which home visits are not made. It is impractical to establish a policy requiring home visits for all applicants, which might require the owner to visit units many miles from the property. For example, an owner may determine that 50 miles is the maximum distance that can be traveled to visit an applicant at home.*

6. *Consideration of extenuating circumstances in the screening process. Owners may consider extenuating circumstances in evaluating information obtained during the screening process to assist in determining the acceptability of an applicant for tenancy. If the applicant is a person with disabilities, the owner must consider extenuating circumstances where this would be required as a matter of reasonable accommodation.*

4-8 Prohibited Screening Criteria

Owners are prohibited from establishing any of the following types of screening criteria.

A. Criteria That Could Be Discriminatory

Owners must comply with all applicable federal, state or local fair housing and civil rights laws and with all applicable civil rights related program requirements.

1. *Owners may not discriminate based on race, color, religion, sex, national origin, age, familial status, or disability.*
2. *Owners may not discriminate against segments of the population (e.g., welfare recipients, single parent households) or against individuals who are not members of the sponsoring organization of the property. Owners may not require a specific minimum income, except as allowed by paragraph 4-7 E.3 of this Handbook.*
3. *These prohibitions apply to (1) accepting and processing applications; (2) selecting tenants from among eligible applicants on the waiting list; (3) assigning units; (4) certifying and recertifying eligibility for assistance; and (5) all other aspects of continued occupancy.*
4. *Complaints alleging violations of these prohibitions must be referred to HUD's Regional Offices of Fair Housing and Equal Opportunity.*

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B. Criteria That Require Medical Evaluation or Treatment

1. *Owners may not require applicants to undergo a physical exam or medical testing such as AIDS or TB testing as a condition of admission.*
2. *Owners may not require pregnant women to undergo medical testing to determine whether she is pregnant in order to assign a unit with the appropriate number of bedrooms.*
3. *Owners may uniformly require all applicants to provide evidence of an ability to meet the obligations of tenancy, but owners may not impose greater burdens on persons with disabilities. Persons with disabilities may meet the requirements of the lease with the assistance of others, including an assistance animal, a live-in aide, or with services provided by someone who does not live in the unit.*

C. Criteria That Require Meals and Other Services

Owners may not require tenants to participate in a meals program that is not approved by HUD.

***NOTE**: 24 CFR, part 278, prohibits HUD from approving new mandatory meals programs after April 1, 1987.*

D. Criteria That Require Donation or Contribution

Owners must not require a donation, contribution, membership fee, application fee, or processing fee as a condition of admission. Cooperative housing projects may charge a membership fee. Owners may not require any payments that are not described in the lease.

E. Criteria That Inquire about Disabled Status

It is unlawful for an owner to make an inquiry to determine whether an applicant, or any person associated with the applicant, has a disability or to make an inquiry about the nature or severity of a disability. However, in accordance with paragraph 4-29, an owner may request supporting documentation in order to verify whether an individual is a qualified individual with a disability when an applicant requests an accessible unit or a reasonable accommodation/modification and must adhere to the guidelines as set forth in 2-31 F. (Refer to Chapter 2 for more information on fair housing requirements.)

F. Criteria Prohibited by State and Local laws

Owners must adhere to state and local laws that prohibit certain screening criteria.

6-15 Collection of the Security Deposit

A. It is recommended the owner collect a security deposit at the time of the initial lease execution.

B. Security deposits provide owners with some financial protection when a tenant moves out of the unit and fails to fulfill his/her obligations under the lease. Additionally, many programs require that owners place security deposits in interest-bearing accounts and allocate the interest to the tenant. This requirement varies by programs and depends to a certain extent on state and local laws.

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C. The owner must collect a security deposit at the time of the initial lease execution for the following properties:

1. *Section 8 New Construction with an AHAP executed on or after November 5, 1979;*
2. *Section 8 Substantial Rehabilitation with an AHAP executed on or after February 20, 1980;*
3. *Section 8 State Agency with an AHAP executed on or after February 29, 1980;*
4. *Section 202/8;*
5. *Section 202 PAC;*
6. *Section 202 PRAC; and*
7. *Section 811 PRAC.*

D. The amount of the security deposit established at move-in does not change when a tenant's rent changes.

E. The amount of the security deposit to be collected is dependent upon:

1. *The type of housing program;*
2. *The date the AHAP or HAP contract for the unit was signed; and*
3. *The amount of the total tenant payment or tenant rent.*

**Figure 6-7* outlines the amount of the security deposit the owner may collect for each of the different programs.*

F. The owner must comply with any applicable state and local laws governing the security deposit.

G. The tenant is expected to pay the security deposit from his/her own resources, and/or other public or private sources.

H. The owner may collect the security deposit on an installment basis.

I. The security deposit is refundable. (See paragraph 6-18 for more information on refunding a security deposit.)

J. An applicant may be rejected if he/she does not have sufficient funds to pay the deposit.

6-16 Security Deposits for Tenants Transferring to Another Unit

A. When a tenant transfers to a new unit, an owner may:

1. *Transfer the security deposit; or*
2. *Charge a new deposit and refund the deposit for the old unit.*

B. If the deposit for the old unit is refunded, the owner must:

1. *Follow the requirements listed in paragraph 6-18 regarding the refunding and use of the security deposit; and*
2. *Establish a security deposit for the new unit based on the requirements listed in paragraph 6-15 regarding the collection of a security deposit.*

Figure 6-7: Amount of Security Deposit to Collect from Tenant

Program	Amount to Collect
Section 8 New Construction with AHAP executed before November 5, 1979	One month's total tenant payment
Section 8 Substantial Rehabilitation with AHAP executed before February 20, 1980	One month's total tenant payment
Section 8 State Agency with AHAP executed before February 29, 1980	One month's total tenant payment
Section 8 New Construction with AHAP executed on or after November 5, 1979 *[24 CFR 880.608]*	The greater of: 1) One month's total tenant payment, or 2) $50
Section 8 Substantial Rehabilitation with AHAP executed on or after February 20, 1980 *[24 CFR 881.601]*	The greater of: 1) One month's total tenant payment, or 2) $50
Section 8 State Agency with AHAP executed on or after February 29, 1980 *[24 CFR 883.701]*	The greater of: 1) One month's total tenant payment, or 2) $50
RHS 515 with Section 8 *[24 CFR 884.115]*	Equal to one month's total tenant payment
Section 8 LMSA with HUD-insured or HUD-held mortgages *[24 CFR 886.116]*	An amount up to, but no greater than, one month's total tenant payment
Section 8 provided with the sale of a HUD-owned property (Property Disposition) *[24 CFR 886.315]*	The greater of: 1) One month's total tenant payment, or 2) $50
Section 202/8 or Section 202 PAC *[24 CFR 891.435]*	The greater of: 1) One month's total tenant payment, or 2) $50
Section 202 PRAC *[24 CFR 891.435]*	The greater of: 1) One month's total tenant payment, or 2) $50
Section 811 PRAC *[24 CFR 891.435]*	The greater of: 1) One month's total tenant payment, or 2) $50
Section 236	One month's tenant rent
Section 236 with RAP	The greater of: 1) One month's total tenant payment, or 2) $50
Section 221(d)(3) BMIR	One month's tenant rent
Rent Supplement	The greater of: 1) One month's total tenant payment, or 2) $50

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(11) Determine whether move-in and move-out inspection forms were completed.
(12) Determine whether the computation of the tenant's contribution toward rent and utilities and the subsidized portion of the tenant's monthly rent were properly calculated.
(13) Determine whether the initial certification and the last recertification forms were completed correctly and were accurate (Form HUD-50059).
(14) Verify that the Section 8 rents charged and paid did not exceed the contract rents approved by HUD.
(15) Trace the housing assistance payment calculated in the tenant file to the amount charged to HUD in the monthly voucher request.

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C. ***Move-In Inspection Requirements***

1. *Before executing a lease, the owner and tenant must jointly inspect the unit.*
2. *After the owner conducts a unit inspection, the inspection form must indicate the condition of the unit. The condition of the unit must be decent, safe, sanitary, and in good repair. If cleaning or repair is required, the owner must specify on the inspection form the date by which the work will be completed. The date must be no more than 30 days after the effective date of the lease.*

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3. *Both the owner and the tenant must sign and date the inspection form. The inspection form must include the statement, "The unit is in decent, safe and sanitary condition".*
4. *The tenant has 5 days to report any additional deficiencies to the owner to be noted on the move-in inspection form.*
5. *The move-in inspection form must be made part of the lease, as an attachment to the lease.*

D. ***Move-Out Inspection Instructions***

1. *Owners are advised to encourage tenants to accompany them on the inspection. Upon a tenant's request, he/she must be allowed to attend the move-out inspection conducted by the owner. If a tenant is with the owner during the inspection, disagreements between the owner and the tenant regarding unit damage can be resolved up front.*
2. *If a tenant does not wish to participate, the owner may do the inspection alone.*
3. *HUD does not provide move-out inspection criteria. It is at the owner's discretion to develop criteria to distinguish between wear-and-tear and damage. If an owner determines that the unit is damaged as a result of tenant abuse or neglect, he/she may use the security deposit to cover the repair costs. (See Section 2: Security Deposits for more information.)*

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(16) For those tenants who were evicted, determine whether
i. The basis for the eviction was in accordance with the established rental policy, or
ii. The tenant was evicted for any discriminatory reasons.
(17) Determine whether any evidence is contained in the file indicating that any improper or inaccurate information was discovered while determining tenant eligibility or rent calculation. If so, determine that the owner followed the guidance in HUD Handbook 4350.3 pertaining to overpayment of a subsidy and follow up on suspected fraud.

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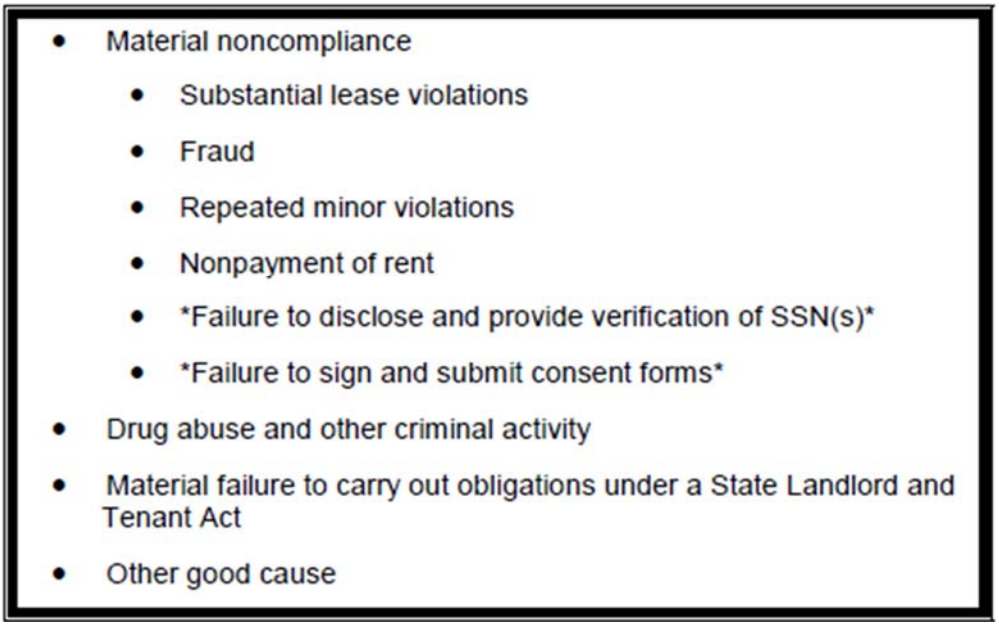
Figure 8-2: Allowable Circumstances for Terminating Tenancy



8-13 Material Noncompliance with the Lease

A. ***Key Requirements***

Owners may terminate tenancy when a tenant is in material noncompliance with the lease, including:

1. *Failure of the tenant to submit in time all required information on household income and composition. Examples include:*
   a. *The tenant's failure to:*
      1) *Submit required evidence of citizenship or eligible immigration status;*
      2) *Disclose and verify social security numbers; or*
      3) *Sign and submit consent forms allowing verification of information regarding the tenant's income and eligibility.*
   b. *The tenant's knowingly providing incomplete or inaccurate information.*
2. *Extended absence or abandonment of the unit as defined in the house rules for the property, or in state or local law.*
   a. *House rules regarding extended absence or abandonment must be consistent with the requirements and guidelines for house rules described in paragraph 6-9. See that chapter for more information.*
   b. *The house rules must be attached to the lease for that unit.*
3. *Fraud, which is when a tenant knowingly provides inaccurate or incomplete information.*
   a. *If the owner determines that a tenant acted fraudulently, the owner may terminate tenancy under the lease. A fraudulent action is considered material noncompliance with the lease.*
   b. *The owner must handle fraud as a civil violation and may handle fraud as a criminal violation. When evicting for fraud, the owner must simultaneously file a civil action against the tenant to recover the subsidy overpayment. The owner may refer the case to a local, state, or federal prosecutor who may pursue the case as a criminal matter.*
   c. *The owner must take care not to confuse tenant error with fraud. Figure 8-3 below describes the difference between fraud and tenant errors. See paragraphs 8-17 and 8-18 for more information.*
4. *Repeated minor violations that:*
   a. *Disrupt the livability of the property;*

b. Adversely affect the health or safety of any person, or the right of any tenant to the peaceful enjoyment of the property;
c. Interfere with the management of the property; or
d. Have an adverse financial effect on the property.

5. Nonpayment of rent due under the lease.
a. The tenant is obligated to pay all amounts due under the lease or repayment agreement, including any portion thereof.
b. The owner must not terminate tenancy until any grace period permitted by state law has expired.

***NOTE:** If the tenant pays all amounts due under the lease within the grace period, this is not material noncompliance, but rather a minor violation. Repeated minor violations constitute cause for eviction.*

*6. *Failure to disclose and provide verification of SSNs.*
a. Termination of tenancy.
1) The owner must terminate tenancy of a tenant and the tenant's household if the SSN disclosure and verification requirements for all household members are not met in the specified timeframe. This includes those households where a child under the age of six who did not have a SSN was added to the household with the understanding that the SSN would be disclosed and verification provided within 90 days after admission, or within the 90 day extension period, if applicable.
2) There is no proration of assistance for those household members who are required to obtain a SSN but who fail to disclose and provide verification of their SSN.
3) Termination of tenancy does not apply to those households with individuals who do not contend eligible immigration status or tenants who were age 62 or older as of January 31, 2010, whose initial determination of eligibility was begun before January 31, 2010, unless there are other members of the household who have not disclosed or provided verification of their SSNs.
b. Deferring termination of tenancy.
The owner may defer termination of tenancy and provide tenants with an additional 90 days past their next regularly scheduled recertification of income and family composition to become in compliance with the SSN disclosure and verification requirements in Chapter 3, Paragraph 3-9.
1) The deferral is at the owner's discretion and must only be provided if failure to meet the SSN requirements was due to circumstances outside the control of the tenant and there is a likelihood that the tenant will be able to disclose and provide verification of the needed SSN(s) by the deadline date.
2) After the 90-day deferral period, if the tenant has not disclosed and provided verification of the needed SSN(s), the owner will pursue termination of tenancy.

B. Procedures for Terminating Tenancy and Providing Notice
The following procedures are the minimum standards required by HUD. Most state and/or local laws are more restrictive than HUD's minimum requirements; therefore, an owner should be aware of state and local laws governing terminations.

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1. Basis for termination.
To terminate tenancy, an owner must establish that the basis for the termination is consistent with:
a. HUD-required lease provisions;
b. Allowable lease provisions set forth in the lease for the unit occupied by the tenant; and
c. Applicable state and local laws.
2. Termination notice.
a. If the owner proposes to terminate a lease, the owner must give the tenant written notice of the proposed termination.
b. For tenants with a disability, the notice must be provided in a form accessible to the tenant (e.g., in Braille or audio form for a tenant with a vision impairment).

c. *When an owner terminates tenancy, written notice must be provided to the tenant and must:*
   1) *State the specific date the tenancy will be terminated;*
   2) *State the reasons for the action with enough detail to enable the tenant to prepare a defense;*
   3) *Advise the tenant that remaining in the unit on the termination date specified in the notice may result in the owner seeking to enforce the termination in court, at which time the tenant may present a defense;*
   4) *Advise the tenant that he/she has 10 days within which to discuss termination of tenancy with the owner. The 10-day period begins on the day that the notice is deemed effective (see subparagraph B.3 below);*
   5) *Advise that persons with disabilities have the right to request reasonable accommodations to participate in the hearing process (see Chapter 2, Subsection 4 for information on Reasonable Accommodation)*
   6) *Be served on the tenant as described under subparagraph B.3.c below.*

d. *When terminating tenancy for material noncompliance, the time of service of the termination notice must be in accordance with the lease and state law.*

e. *In the case of the tenant's nonpayment of rent, the notice must include the dollar amount of the balance due on the rent account and the date of such computation.*

3. *Manner of service for Section 236, Section 221(d)(3) BMIR, Rent Supplement, Section 202/8, Section 202 PAC, Section 202 PRAC, Section 811 PRAC, Section 8 Loan Management Set-Aside, and Section 8 Property Disposition Set-Aside.*

   a. *The notice must be served by:*
      1) *Sending a letter by first class mail, properly stamped and addressed and including a return address, to the tenant at the unit address; and*
      2) *Delivering a copy of the notice to any adult person answering the door at the unit. If no adult answers the door, the person serving the notice may place it under or through the door, or affix it to the door.*

   b. *The date on which the notice is deemed received by the tenant is the later of:*
      1) *The date the first class letter is mailed; or*
      2) *The date the notice is properly given.*

   c. *Service of the notice is deemed effective once the notice has been both mailed and hand delivered.*

4. *Manner of service for all other Section 8 programs.*

   The manner of service will be in accordance with the provisions of state and local laws.

5. *Judicial action.*

   a. *An owner must not evict any tenant except by judicial action pursuant to state and local laws.*

   b. *In any judicial action to evict a tenant, the owner must rely on the grounds cited in the termination notice served to the tenant. However, the owner is not precluded from relying on grounds about which he/she had no knowledge of at the time the notice was sent to the tenant.*

   NOTE: *For Section 8 New Construction, Substantial Rehabilitation, and State Agency properties, the owner must rely only on the grounds cited in the termination notice served to the tenant.*

   c. *The tenant's failure to object to the notice does not constitute the tenant's waiver of his/her rights to contest the owner's action in a judicial proceeding.*

   d. *A tenant may rely on state or local laws governing eviction procedures where such laws provide the tenant procedural rights that are in addition to those provided by the regulatory agreements, except where such laws have been preempted under CFR Part 246, Local Rent Control, or by other action of the United States.*

K. UNITS LEASED TO EXTREMELY LOW-INCOME FAMILIES.

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1. Compliance Requirement. For each project assisted under a contract for project-based Section 8 assistance, the owner must lease not fewer than 40 percent of the dwelling units to extremely low-income families (HUD Handbook 4350.3, chapter 3, and chapter 4, paragraph 4-5).
2. Suggested Audit Procedures.
   a. Select a sample of Section 8 tenants or use the sample selected in step 3-5.J above if all tenants in that sample receive subsidy. For the sample items selected,
      (1) Obtain a copy of the tenant selection plan for a description of the methodology the owner uses in income targeting.
      (2) Obtain an understanding of the owner/management agent's procedures for implementing that plan and determine whether the procedures properly implement the tenant selection plan.

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   b. Determine whether at least 40 percent of the units that became available during the period under review served extremely low-income families.
      (1) If the tenant files that were stated in the owner's income target determination were in the sample selected, determine that extremely low-income families occupied those units.
      (2) If none of the extremely low-income families were in the sample selected, select a separate sample from the owner's determination documentation and determine whether the units were rented to extremely low-income families.
   c. If the 40 percent has not been reached and the owner is renting units to other eligible families, determine whether the owner has documented its marketing efforts to target extremely low-income families.

AHACPA Comment – Although item K was not included in the allowance for group-based project sample, HUD OIG has allowed that sample item selected from the previous sample of tenant files that pertain to the ELI testing could be used to satisfy a portion of the sample requirements. Therefore, the previous sample included 10 tenants who qualified as ELI, then the auditor should select additional sample items to obtain the required sample size.

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*B. **Methods to Comply with Income-Targeting Requirements***
HUD does not prescribe a method for achieving compliance with the income targeting requirement. Before determining a specific method to achieve income targeting requirements, it is a good practice for owners to evaluate the expected admissions based upon the current waiting list.

1. First, owners should determine whether the composition of a property's current waiting list enables the owner to achieve the income-targeting requirement by simply following the standard waiting list order with no additional procedures. If the current waiting list includes a significant number of extremely low-income applicants, an owner may be able to meet the 40% target with no additional procedures.

***NOTE:** In such cases, it is important that owners periodically review the composition of admissions to confirm that the 40% target will be met for that fiscal year. If an owner's periodic review reveals that admissions of extremely low-income applicants are below the 40% requirement, the owner may need to begin using additional procedures to ensure that the requirement is met by the end of the fiscal year. The owner's Tenant Selection Plan must clearly describe what method will be used and what admission statistics will trigger implementation of the special selection method.*

2. If an owner determines that following the property's waiting list in standard chronological order may not (or will not) achieve the admissions necessary to meet the income-targeting requirement, then the owner must implement procedures that will ensure compliance.

a. To aid in determining the tenant selection procedures that will ensure compliance, HUD recommends that owners examine the volume of unit turnover and applicant admissions for at least the past two years and, based on this information, estimate the likely number of admissions for the coming fiscal year.

b. Owners may choose any of the following methods, or may develop another method that is consistent with applicable civil rights requirements and does not result in disparate treatment of applicants with respect to any of the protected bases (see Chapter 2). Regardless of the method implemented by the owner, that method must be described in the Tenant Selection Plan.

(1) Method 1 – Admit only extremely low-income families until the 40% target is met. In chronological order, owners select eligible applicants from the waiting list whose incomes are at or below the extremely low-income limit to fill the first 40% of expected vacancies in the property. Once this target has been reached, admit applicants in waiting list order.

(2) Method 2 – Alternate between the first extremely low income applicant on the waiting list and the applicant at the top of the waiting list. To implement this method, owners select the first extremely low-income applicant on the waiting list (which may mean "skipping over" some applicants with higher incomes) for the available unit, and then select the next eligible applicant currently at the top of the waiting list (regardless of income level) for the next available unit. As subsequent units become available, tenant selection continues to alternate between the next extremely low-income applicant and the eligible applicant at the top of the waiting list until the 40% target is reached.

***NOTE:** It is possible that:*

- *Selection of the "next extremely low-income applicant" may result in selecting the applicant at the top of the waiting list; or*
- *Selection of the "eligible applicant at the top of the waiting list" may result in the selection of an extremely low-income family.*

(3) Method 3 - Alternate between the first extremely low income applicant on the waiting list and the applicant at the top of the waiting list in groups of 10. In chronological order, owners admit the first 4 extremely low-income families from the waiting list and then admit the next 6 families from the top of the waiting list, regardless of income. This procedure results in 40% or more of admissions being extremely low-income. After filling the first 10 available units, owners again admit the first 4 extremely low-income families on the waiting list and then the next 6 families currently at the top of the waiting list.

***NOTE:** For more information about meeting income-targeting requirements, and examples of selecting applicants properly from the waiting list, see paragraph 4-25 of this chapter.*

L. TENANT SECURITY DEPOSITS.

1. Compliance Requirement. Funds collected as a security deposit shall be kept in the name of the project, separate and apart from all other funds of the project in a trust account. The amount of this account shall at all times equal or exceed the aggregate of all outstanding obligations under that account. Funds must not be commingled with funds from any other projects. All disbursements from the security deposit

account must be only for refunds to tenants and for payment of expenses incurred by or on behalf of the tenant, not to exceed the amount to which the tenant is entitled. All disbursements must have supporting documentation. In addition, state and local governments may have specific regulations governing the handling of tenant security deposits.

2. Suggested Audit Procedures.

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a. Obtain an understanding of the project owner's procedures, including state and local laws, and regulatory agreement and HUD requirements (HUD Handbook 4370.2, chapter 2) for establishment and maintenance of the security deposit account and making approved disbursements from that account.
b. Determine whether the account has been established in a federally insured depository in the name of the project, which is segregated from project operating funds, and the owner's records support the amount on deposit.
c. Determine whether, at the end of the reporting period and throughout the period under review, the amount on deposit is at least equal to the outstanding obligations under the security deposit account.
d. Determine whether interest is earned on the security deposit account and the disposition of that interest. If state and local law requires the owner to pay the tenant for interest earned, determine that the tenant interest is credited to tenants and paid upon termination of tenancy.

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e. Select a sample of tenants that moved in and tenants that moved out during the period under review and perform the following steps:
   (1) Determine whether security deposits were collected at the time of the initial lease and agree with the amount required in the lease agreement and regulations.
   (2) Determine whether security deposits collected were deposited promptly in the security deposit account.
   (3) Trace tenant balances reported on the balance sheet at the end of the fiscal year as the outstanding obligation to the tenant list of security deposits for the same period and determine if it agrees.
   (4) Determine whether refunds and/or an itemized list of claims were provided to tenants within 30 days after move-out or as required by state or local law.
   (5) Determine whether refunds were disbursed to the former tenant and in the appropriate amount. Determine the disposition of or proposed disposition of the amounts for checks outstanding for more than 60 days.
   (6) Identify disbursements from the security deposit bank account statement that do not appear to be tenant refunds to ensure that those disbursements were only made for payment of appropriate expenses incurred by the tenant or on behalf of the tenant.
   (7) Determine whether forfeited security deposits applied to rents and damages were appropriately recorded as rental income.

6-15 Collection of the Security Deposit

A. It is recommended the owner collect a security deposit at the time of the initial lease execution.
B. Security deposits provide owners with some financial protection when a tenant moves out of the unit and fails to fulfill his/her obligations under the lease. Additionally, many programs require that

owners place security deposits in interest-bearing accounts and allocate the interest to the tenant. This requirement varies by programs and depends to a certain extent on state and local laws.

C. The owner must collect a security deposit at the time of the initial lease execution for the following properties:
   1. Section 8 New Construction with an AHAP executed on or after November 5, 1979;
   2. Section 8 Substantial Rehabilitation with an AHAP executed on or after February 20, 1980;
   3. Section 8 State Agency with an AHAP executed on or after February 29, 1980;
   4. Section 202/8;
   5. Section 202 PAC;
   6. Section 202 PRAC; and
   7. Section 811 PRAC.

D. The amount of the security deposit established at move-in does not change when a tenant's rent changes.

E. The amount of the security deposit to be collected is dependent upon:
   1. The type of housing program;
   2. The date the AHAP or HAP contract for the unit was signed; and
   3. The amount of the total tenant payment or tenant rent.

   **Figure 6-7* outlines the amount of the security deposit the owner may collect for each of the different programs.*

F. The owner must comply with any applicable state and local laws governing the security deposit.

G. The tenant is expected to pay the security deposit from his/her own resources, and/or other public or private sources.

H. The owner may collect the security deposit on an installment basis.

I. The security deposit is refundable. (See paragraph 6-18 for more information on refunding a security deposit.)

An applicant may be rejected if he/she does not have sufficient funds to pay the deposit.

6-16 Security Deposits for Tenants Transferring to Another Unit

A. When a tenant transfers to a new unit, an owner may:
   1. Transfer the security deposit; or
   2. Charge a new deposit and refund the deposit for the old unit.

B. If the deposit for the old unit is refunded, the owner must:
   1. Follow the requirements listed in paragraph 6-18 regarding the refunding and use of the security deposit; and
   2. Establish a security deposit for the new unit based on the requirements listed in paragraph 6-15 regarding the collection of a security deposit.

***Figure 6-7*: Amount of Security Deposit to Collect from Tenant**

Program	Amount to Collect
Section 8 New Construction with AHAP executed before November 5, 1979	One month's total tenant payment
Section 8 Substantial Rehabilitation with AHAP executed before February 20, 1980	One month's total tenant payment
Section 8 State Agency with AHAP executed before February 29, 1980	One month's total tenant payment
Section 8 New Construction with AHAP executed on or after November 5, 1979 *[24 CFR 880.608]*	The greater of: 1) One month's total tenant payment, or 2) $50
Section 8 Substantial Rehabilitation with AHAP executed on or after February 20, 1980 *[24 CFR 881.601]*	The greater of: 1) One month's total tenant payment, or 2) $50
Section 8 State Agency with AHAP executed on or after February 29, 1980 *[24 CFR 883.701]*	The greater of: 1) One month's total tenant payment, or 2) $50
RHS 515 with Section 8 *[24 CFR 884.115]*	Equal to one month's total tenant payment
Section 8 LMSA with HUD-insured or HUD-held mortgages *[24 CFR 886.116]*	An amount up to, but no greater than, one month's total tenant payment
Section 8 provided with the sale of a HUD-owned property (Property Disposition) *[24 CFR 886.315]*	The greater of: 1) One month's total tenant payment, or 2) $50
Section 202/8 or Section 202 PAC *[24 CFR 891.435]*	The greater of: 1) One month's total tenant payment, or 2) $50
Section 202 PRAC *[24 CFR 891.435]*	The greater of: 1) One month's total tenant payment, or 2) $50
Section 811 PRAC *[24 CFR 891.435]*	The greater of: 1) One month's total tenant payment, or 2) $50
Section 236	One month's tenant rent
Section 236 with RAP	The greater of: 1) One month's total tenant payment, or 2) $50
Section 221(d)(3) BMIR	One month's tenant rent
Rent Supplement	The greater of: 1) One month's total tenant payment, or 2) $50

6-17 Interest Earned on the Security Deposit

A. Section 8 New Construction, Substantial Rehabilitation, and State Agency properties are subject to two different sets of requirements depending on the date the AHAP was signed. Additionally, Section 202 properties with Section 8 or PAC have additional requirements for allocating interest and maintaining records. To further complicate the process, most states (and some counties and municipalities) have laws regarding the investment of security deposits and payments to the tenant of interest earned on the deposits, with which owners must comply. In instances where laws conflict, owners should follow the requirements that provide the greatest benefit to the tenant.

Owners must comply with any state and local laws regarding investment of security deposits and distribution of any interest earned thereon. If state law is silent, or if HUD regulations are more demanding, owners must comply with HUD's regulations. HUD requirements are discussed below.

In addition, interest to the tenants must be computed in accordance with state or local law. When state or local law is silent, the actual rate earned on the security deposits must be computed and credited to each tenant's portion of the security deposit.

B. The owner must place the security deposits into a segregated, interest-bearing account. The balance of the account must equal the total amount collected from all tenants then in occupancy plus any accrued interest.

***NOTE**: For Section 202/8, Section 202 PRACs, and Section 811 PRACs, the balance must equal the total amount collected from all tenants then in occupancy, plus any accrued interest and less allowable administrative cost adjustments.*

***NOTE**: For Section 202/8, the allowable administrative costs may not exceed the accrued interest allocated to the family's balance for the year.*

***NOTE**: Owners of the following properties are not subject to the revised Section 8 regulations. Subject to state and local requirements, these properties may invest security deposits and deposit the interest into the property's operating account on a quarterly basis.*

1. *Section 8 New Construction with an AHAP executed before November 5, 1979.*
2. *Section 8 Substantial Rehabilitation with an AHAP executed before February 20, 1980.*
3. *Section 8 State Agency with an AHAP executed before February 29, 1980.*

C. In addition to the other requirements listed in this section, Section 202 properties with Section 8 or PAC are subject to the following:

1. *The owner must maintain a record of the amount in the segregated interest-bearing account that is attributable to each tenant.*
2. *The owner must allocate interest accrued on the tenant's security deposit on an annual basis and when a tenant vacates the unit.*
3. *Unless prohibited by state or local law, the owner may deduct, from the accrued interest attributable to the tenant for the year, the administrative cost of computing the allocation of interest to the tenant's security deposit balance. The amount of the administrative cost must not exceed the accrued interest allocated to the tenant's balance for the year.*

D. Although not a specific requirement for every program, it is in the owner's best interest to:

1. *Maintain a record of the amount in the security deposit account attributable to each tenant; and*
2. *Allocate interest to the tenant's security deposit on an annual basis and when a tenant vacates the unit.*

6-18 Refunding and Use of the Security Deposit

A. In order to receive a refund of the security deposit, a tenant must provide the owner with a forwarding address or arrange to pick up the refund. [24 CFR 880.608(c), 881.601, 883.701, 891.435(b)(2), 891.635, and 891.775]

***NOTE**: The regulations do not require the tenant to provide this type of notification to the owners in RHS 515 properties with Section 8 and properties with Section 8 LMSA and Section 8 PDSA. However, state law typically requires owners to attempt to refund a tenant's security deposit.*

B. Subject to state and local laws, an owner may use the tenant's security deposit as reimbursement for any unpaid rent or other amounts the tenant owes under the lease.

C. Within 30 days after the move-out date (or shorter time if required by state and/or local laws), the owner must either:

1. Refund the full security deposit plus accrued interest to a tenant that does not owe any amounts under the lease; or

2. Provide the tenant with an itemized list of any unpaid rent, damages to the unit, and an estimated cost for repair, along with a statement of the tenant's rights under state and local laws.

a. If the amount the owner claims is less than the security deposit plus accrued interest, the owner must refund the unused balance to the tenant.

b. If the owner fails to provide the list to the tenant, the tenant is entitled to a full refund of the tenant's security deposit plus accrued interest.

***NOTE**: State laws may also have requirements regarding itemizing damages. When a specific federal housing program does not require an itemized list (as is the case for properties with Section 8 LMSA and Section 8 PDSA), owners must be aware of any state or local law that obligates an owner to provide the tenant with an itemized list of damages.*

D. If a disagreement arises concerning the reimbursement of the security deposit to the tenant, the tenant has the right to present objections to the owner in an informal meeting. The owner must keep a record of any disagreements and meetings in the tenant file for a period of three years for inspection by the HUD Field Office or Contract Administrator. These procedures do not preclude the tenant from exercising any rights under state and local law.

***NOTE**: The regulations for RHS 515 properties with Section 8 and properties with Section 8 LMSA and Section 8 PDSA do not require an owner to meet with the tenant or keep a record of the meeting or any disagreements.*

E. If the security deposit is insufficient to reimburse the owner for any unpaid rent or other amounts that the tenant owes under the lease, the owner may be able to claim reimbursement from the HUD Field Office or Contract Administrator.

F. Any reimbursement from HUD received by the owner must be applied first toward any unpaid tenant rent due under the lease. Additionally, no reimbursement may be claimed for unpaid rent for the period after termination of the tenancy.

2017 Regulatory Agreement

Any funds collected as security deposits shall be kept (a) separate and apart from all other funds of the Project; (b) in interest bearing trust accounts, to the extent required by State or local law; and (c) in an amount which shall at all times equal or exceed the aggregate of all outstanding obligations under said account. Security deposit account interest shall be paid on a pro rata basis to tenants or applied to sums due under their leases upon the termination of their tenancy in the
Project. The use of tenant security deposits for Project operations is prohibited unless the tenant has forfeited the deposit.

M. MANAGEMENT FUNCTIONS.

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1. Compliance Requirement. The owner is responsible for complying with all requirements of the regulatory agreement. *The owner may perform all management functions or contract with a management agent to provide project management, but the responsibility cannot be delegated to the management agent. The owner or management agent must be approved by HUD and must certify that it will follow HUD's rules and regulations. *

2. Suggested Audit Procedures.

a. Obtain a copy of the most recent HUD-approved management agent's certification (Form HUD-9839-A, B, or C, as appropriate). Perform the following steps:

(1) Determine whether HUD has approved the owner or current management agent.

(2) If the project owner's/management agent's certification, Form HUD-9839-B, was used, determine whether companies that have an identity-of-interest relationship with the owner (item 12) have been reported in the notes to the financial statements.

(3) Obtain a copy of the management entity profile, Form HUD-9832, to identify additional identity-of-interest companies *(items 11a and b) that were not included in the management agent certification for inclusion in the notes to the financial statements.

(Handbook 4381.5)

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2.2 AGENT SELECTION AND APPROVAL AUTHORITY

The project owner is responsible for seeking out and selecting a management agent, but the selection is subject to the approval of the authorizing agency. This authorizing agency may be HUD, or it may be ARHEDS or the state/local agency, depending upon the project type and the mortgage insurance coverage. See Figure 2-1.

HUD

All multifamily projects insured or financed directly by HUD, and HUD-assisted multifamily projects where HUD is the Contract Administrator.

State/local

Non HUD-insured multifamily housing projects where a state agencies or local housing agency financed the project or serves as the Contract Administrator for HUD assistance. HUD Area offices perform Previous Participation review to determine agent eligibility.

2.3 TYPES OF MANAGEMENT AGENTS

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Four Types of Management Agents

1. *Owner/Manager (self-managed)*
2. *Identity of Interest Management Agent*
3. *Independent Fee Agent*
4. *Project Administrator*

The term "management agent" applies to all four forms of management agents unless a specific distinction is made because of policy or procedural differences.

Key Steps in Management Agent Approval Process

1. *The project owner selects proposed management entity.*
2. *The owner submits required documentation to HUD.*

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3. *HUD reviews the project owner's submission to assess proposed agent's:*
   - *eligibility*
   - *past performance*
   - *management capacity and experience*
   - *fidelity bond coverage.*
4. *HUD issues a decision letter.*
5. *The owner executes an acceptable Management Agreement with the agent.*

2.9 OWNER/MANAGEMENT ENTITY APPROVAL SUBMISSION REQUIREMENTS

To request approval of the management entity, the owner/agent must submit the following information to the HUD Area Office at least 60 days before the date the owner wishes the new agent to assume responsibility.

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a. *Previous Participation Certification. Form HUD-2530 (see Appendix 1) reports the names of all principals and affiliates of the management agent and any previous housing projects in which they have participated.*
b. *Management Entity Profile - Form HUD-9832*
c. *Management Certification. Using Form HUD-9839a, b, or c, as appropriate,*
   (1) Owner-Managed Projects submit Form HUD-9839a
   (2) Identity-of-Interest Agents submit Form HUD-9839b
   (3) Independent Fee Agents submit Form HUD-9839b
   (4) Project Administrators submit Form HUD 9839c.
d. *Proposed Staffing to be Charged Against the Project Operating Account. Owners/agents must provide a listing of the staff whose salaries will be paid from the project's operating account.*
   The list must include:
   (a) Job titles and approximate salary, including hourly rate;
   (b) A statement of each position's duties, if not obvious by title and whether the position is full or part-time;
   (c) If the employee will be working for more than one project and/or working part-time for the agent in a non-supervisory capacity, a statement of how that person's time and salary will be allocated.
e. *Resident Complaints and Their Resolution. Owners must provide a description of the system employed by the agent for resolving resident complaints and actual examples of the agent's implementation of the system.*
f. *Additional Information Required by the HUD Area Office. The Loan/Asset Management staff may require owners to submit additional information to clarify materials already submitted.*

Different rules for 202 projects (see 2.11)

2.12 REVIEW OF AGENT PERFORMANCE, EXPERIENCE, AND CAPABILITY

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Loan/Asset Management staff must review the qualifications of the proposed agent to assess the agent's ability to manage the project effectively and in compliance with HUD requirements. Loan/Asset Management staff must consider the following factors:

a. *Past and current Management*
   (1) Loan/Asset Management staff must review the proposed agent's past experience.

(2) If problems are identified with any of these indicators, Loan/Asset Management staff must assess whether the agent has adequately improved its procedures to prevent the recurrence.

b. Ability to Manage Troubled Projects.
c. Management Qualifications.
d. Past Performance with IOI Contractors.

2.14 BONDING REQUIREMENTS FOR AGENTS

Loan/Asset Management staff must also determine whether the agent has adequate bonding. The Loan/Asset Management staff may not waive these minimum fidelity bond requirements. To provide a basic level of protection for the multifamily project assets:

a. The management agent must certify in the Management Certification that it carries fidelity bond or employee dishonesty coverage for:
(1) All principals of the management entity, and
(2) All persons who participate directly or indirectly in the management and maintenance of the project and its assets, accounts, and records.
b. The fidelity bond or coverage must name the mortgagee and HUD as additional loss payees.
c. Coverage may be through one or more bonds, and one bond may cover more than one project, including projects whose mortgages are not insured or held by HUD.

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(4) Review maintenance contracts and major contracts and vendor invoices to determine whether there are additional identity-of-interest relationships with the owner/agent that need to be reported to HUD and in the notes to the financial statements.
(5) Determine whether the management agent fees paid exceeded the amount listed on the management agent certification. This amount should also agree with the amount in the management agreement.
(6) For payments made to identity-of-interest companies, determine whether the amounts paid exceed the amounts ordinarily paid for such services and supplies. The amounts ordinarily paid can be determined by comparing costs to similar disbursements noted during the cash disbursement analysis or from the auditors' knowledge of amounts generally paid for services and supplies in the same geographic area, gained through their audits of other area clients.

2.17 MANAGEMENT AGREEMENT REQUIREMENTS

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a. Applicability. Projects with identity-of-interest agents or independent fee agents must execute a Management Agreement. An Agreement is recommended, but not required, for owner-managed projects or projects managed by a project administrator.
b. Required contents. The owner and agent may negotiate their own form of agreement provided that it contains language to meet the following requirements:
(1) Scope of service. All management agreements must describe the services the agent is responsible for performing and for which the agent will be paid management fees.
(2) Required clauses. All agreements must provide that:
(a) Management fees will be computed and paid according to HUD requirements.

(b) HUD may require the owner to terminate the agreement:
(i) Immediately, in the event a default under the Mortgage, Note, Regulatory Agreement, or Subsidy Contract attributable to the management agent occurs;
(ii) Upon 30 days written notice, for failure to comply with the provisions of the Management Certification or other good cause; or
(iii) When HUD takes over as MIP.

NOTE: As a good business practice, the management agreement should always give the owner the ability to terminate the contract for cause, with notice.

(c) If HUD terminates the agreement, the owner will promptly make arrangements for providing management satisfactory to HUD.
(d) HUD's rights and requirements will prevail in the event the management agreement conflicts with them.
(e) The management agent will turn over to the owner all of the project's cash, trust accounts, investments, and records immediately, but in no event more than 30 days after the date the management agreement is terminated.

(3) Prohibited "hold harmless" clause. Management Agreements cannot exempt the agent from all liability for damages and injuries.

c. Length/term of the Agreement.

Allowable Management Fees From Project Funds

3.2 TYPES OF MANAGEMENT FEES

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A. There are five major types of fees that, when added together, make up the overall management fee for a project. The five types of fees are:
(1) Residential income fee;
(2) Commercial income fee;
(3) Miscellaneous income fee;
(4) Special fees; and
(5) Add-on fees.

b. Fees derived from project income (residential, commercial, and miscellaneous) must be quoted and calculated as a percentage of the amount of income collected by the agent. Multiplying the fee percentage by the income collected gives the actual amount of fee paid to the agent. This requirement serves two purposes.

c. Both special fees and add-on fees are quoted as dollar per unit amounts because they relate to project conditions that are not a function of project rents or income.

3.3 RESIDENTIAL INCOME FEE

HUD specifies the kinds of income that may be treated as residential income when determining the residential income fee. In general, income received from the rental of housing units may be counted as residential income. Figure 3-1 indicates the types of income that may and may not be included in the residential income base amount used when calculating this fee.

Determining Residential Income
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DO COUNT	*DO NOT COUNT*
1. Apartment rents.	*1. Section 8 Special Claims:*
	a) unpaid rents
2. Cooperative carrying charges.	*b) vacancy loss*
	c) debt service
3. Rent Supplement payments.	*d) resident damages.*
4. RAP payments.	*2. Excess rents and charges for Section 236 when the unit rent paid is greater than the unit Basic Rent. (This condition applies regardless of whether the excess income is due to HUD.)*
5. Section 8 regular tenant assistance payments (including utility reimbursement payments made to residents whose Total Tenant Payment is less than the utility allowance).	*3. Section 236 Interest Reduction Payments (IRPs) made to Mortgagees on Section 236 projects.*

3.4
3.5 COMMERCIAL INCOME FEE

Most sources of commercial income may be counted when establishing the income base for this fee. Figure 3-2 shows the types of income that may be counted as commercial income.

Figure 3-2
Determining Commercial Income

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DO COUNT	*DO NOT COUNT*
1. Rent receipts from commercial space.	*1. Charges for services paid directly to an outside vendor or contractor.*
2. Fees for parking spaces or garages.	
3. Charges collected by the agent for additional services not included in project rents.	

3.5 MISCELLANEOUS INCOME FEE

116e-f

a. HUD will allow management agents to earn fees only on selected types of miscellaneous income. Figure 3-3 lists the types of income that may and may not be counted in the miscellaneous income base amount.

Figure 3-3
Determining Miscellaneous Income

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DO COUNT	*DO NOT COUNT*
1. Laundry and concession income (e.g., coin machines, car wash, cable TV, etc.).	*1. Interest earned on invested security deposits, reserves, or other project funds.*
2. Charges collected from residents, such as fees for damages, bad checks, and late payments.	*2. Section 8 Special Claims for unpaid rent, vacancy loss, debt service, or resident damages.*
3. Proceeds from Loss of Rents Insurance policies.	*3. Flexible Subsidy Funds, except as provided for in the MIO plan.*
4. Income from furniture, equipment, and other charges shown on the HUD-approved Rent Schedule (Form HUD-92458).	*4. Refunds from property tax or utility rate appeals.*
5. Pet fees - for clean-up, etc. (not pet deposits).	*5. Proceeds from property damage or liability insurance policies*
	6. Recovered legal fees and court Costs.
	7. Replacement reserve and residual receipts reimbursements to the project

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c. Bookkeeping Expenses Are Treated as a project Cost. The cost of bookkeeping services for a project performed as part of a centralized bookkeeping system are treated as a project cost and should not treated as a special fee. Such expenses are paid out of project funds based on actual costs attributable to the project. Further guidance on the treatment of such costs and the amount payable out of project funds is provided in Chapter Six, paragraph 6.37.

FINANCIAL COMPLIANCE

6.37 ASSIGNING MANAGEMENT COSTS

116h

a. HUD allows owners to charge certain management costs to the project's operating account. However, other management costs may be paid only out of the management fee. The assignment of these costs is discussed in paragraphs 6.38 and 6.39. Asset management costs for the project must be paid out of distributions to the owner. The assignment of asset management costs is described in paragraph 6.41.

b. In reviewing a project's financial statements, Loan/Asset Management staff should follow the procedures in paragraphs 6.38 through 6.41 and in Handbook 4370.2 to ensure that management costs have been properly assigned.

c. Rather than maintaining separate payroll and separate fringe benefits plans for each property, some agents consolidate payroll and fringe benefit plans in order to reduce costs for the properties. In such a system, all personnel for several

properties are listed under a single Federal Employer I.D. Number. The salary and fringe benefits costs are prorated to the various properties in the following ways.

(1) Salaries and fringe benefits of personnel performing front-line duties are prorated among the properties served in proportion to actual use.

(2) The agent may not impose surcharges or administrative fees in addition to actual costs.

(3) The properties served may make reimbursement payments to the consolidated employer upon issuance of payroll checks.

(4) Discounts, rebates, dividends, commissions, or other recoveries of fringe benefits costs must be prorated among the properties served in proportion to actual use during the period to which the recovery applies.

6.38 MANAGEMENT COSTS CHARGED TO THE PROJECT'S OPERATING ACCOUNT

a. Front-line Costs and Day-to-Day Activities

116i

(1) Reasonable expenses incurred for front-line management activities may be charged to the project operating account. HUD Handbook 4370.2, Financial Operations and Accounting Procedures for Insured Multifamily Projects, provides a complete listing of allowable expenses. Front-line activities include:

- *taking applications;*
- *screening, certifying, and recertifying residents;*
- *maintaining the project; and*
- *accounting for project income and expenses.*

Figure 6-2

Examples of Costs Paid from Management Fee and Project Account

Costs Paid from Fee	Costs Paid from Project Account
The selection and establishment of an accounting system and internal management control procedures. Visits to spot check performance of on-site staff (e.g., reviews of occupancy files, office procedures, etc.).	Reimbursement of all costs related to maintaining a centralized or project-based accounting functions of the project, including resident certifications, worksheets, and monthly subsidy billings, as well as monthly accounting reports required by the owner or HUD. Includes prorated costs on a per-unit basis for centralized accounting systems, including hardware, software and technical support. Agent can be reimbursed for the prorated cost to the project of personnel providing property-specific accounting and computer services. The cost to the project for such services provided by the agent may

	not exceed the cost of procuring comparable services from an independent vendor. Each year, the agent must determine that these costs are at or below the market and maintain such evidence on-site.
Fidelity bond coverage for the agent's supervisory staff.	*Fidelity bond coverage for front-line employees and principal management staff.*
Bookkeeping expenses attributable to agent's company. *Overhead expenses (e.g., supplies and equipment, transportation and phone calls to projects, regularly scheduled long distance calls from project to agent, office space, data processing, etc).*	*Costs of front-line project operations -- e.g., managers and their apartments, legal and auditing expenses, bookkeeping and associated expenses, occupancy clerks, project management delinquency notices, evictions, project checks, envelopes, postage, air express delivery charges, copying, unscheduled long distance calls to agent, costs of IRS Section 401-K, 125, and 403-B, and related retirement and health plans for on-site staff so long as* *they are comparable with industry standards and in compliance with the guidelines set forth in paragraph 6.38(e), and the salary of a supervisory employee of the agent designated to replace a project employee for hours worked at the project above and beyond the first 40 consecutive hours of the assignment.*
Directing the investment of project funds.	*Reasonable brokerage fees and interest costs incurred in investing project funds*
Agent's travel expenses to visit project and meet with owners. Training and travel expenses for agent's supervisory staff.	*Travel expenses incurred by front-line staff's responsibilities (e.g., making bank deposits, meeting with contractors, attending training, etc.).*
Agent office phone lines not dedicated to TRACs or the project, and automation	*Dedicated line and modem for transmitting TRACs data (such lines can be shared with FAX machines).*

equipment not required by HUD.	*Automation required by HUD (e.g., equipment for the implementation of TRACs). Reasonable costs for on site equipment, software, and technical support necessary for performing other front-line activities of the project, including FAX machines, automated credit terminals, and other telephones and electronic transmission devices at the site.*

Recruiting costs for agent's staff, Recruiting costs for on-site staff, including roving staff members.

(2) If front-line management functions for several properties are performed by staff of the agent operating out of a single office, the following conditions apply.

116j

(a)The agent must prorate the total associated costs among the projects served in proportion to the actual use of services. Allowable total associated costs include:

(i)Salaries and fringe benefits of personnel performing front-line duties; and

(ii) Actual office expenses, fees, and contract costs directly attributable to the performance of front-line duties.

(b) The agent may not impose surcharges or administrative fees in addition to actual costs.

(c) The cost of performing front-line management functions off-site may not exceed the total cost of performing these functions at the property.

(3) The salaries of the agent's supervisory personnel may not be charged to project accounts, with the exception of supervisory staff providing oversight for centralized accounting and computer services for the project.

b. Agent Staff Performing Front-Line Functions

A management agent employing generalist staff members specifically designated to assume front-line responsibilities on an as-needed basis may bill the project's operating account for time spent on front-line activities for the property if each of the following conditions are met.

(1) Salaries of an agent's supervisory personnel may not be charged to the project's operating account (See exceptions to this rule in paragraph 6.39).

(2) The agent develops a job description for each generalist position outlining the front-line and non-front-line responsibilities of the position. The non-front-line responsibilities in the generalist description may not include supervisory functions.

(3) The agent develops a reasonable hourly rate, which will be used to bill individual projects for time spent on front-line functions. A reasonable hourly rate includes the hourly salary for the position and an allocation for overhead expenses, and should not exceed the amount that would be paid to an on-site staff member with similar experience.

(4) An agent's generalist staff must document hours spent and duties performed on front-line activities for each project and those spent on the central office functions. Weekly timesheets are an acceptable method of documenting hours spent on front-line tasks.

c. Training Costs for Front-Line Staff

(1) Project funds may be used to obtain project related training for front-line management staff.

(2) Loan/Asset Management staff may use the following guidelines to assess whether amounts proposed for training are reasonable.

(a) *At a minimum, the budget amount should be sufficient to allow one staff person from each functional area to attend a minimum of one project related training session per year.*
(b) *As a rule of thumb for most projects, a reasonable training budget would not exceed the greater of $5,000 or one half of one percent (0.005) of gross rents.*
(c) *Loan/Asset Management staff have the authority to approve training budgets that exceed the guidelines in paragraph (b) above if the owner/agent can clearly document the conditions that necessitate more extensive training for project staff.*

d. Training Costs for Board Members of Resident-Owned/Co-op Housing

116k

(1) Project funds may be used to provide project related training for the Board of Directors of a housing cooperative.
(2) Project funds approved by the Board may be used to pay for each board member to attend one project related training session or conference per year.
(3) The guidelines presented in paragraph 6.38c(2)(b) and 6.38c(2)(c) should be used in evaluating whether the amounts proposed for training are reasonable.

e. Retirement Accounts for Front-Line Staff

(1) Funding of retirement accounts for front line staff can be paid out of a project's operating account. Retirement accounts for an agent's central office staff may be paid only out of the management fee.
(2) HUD will allow employer contributions to retirement accounts for front-line staff to be paid out of project funds if the following requirements are satisfied.
(a) The retirement account plan complies with all applicable federal, state, and local laws and regulations governing such programs.
(b) Only permanent, front-line employees who work full-time at the project (i.e., more than 10 hours per week) may participate. Temporary or part-time on-site employees are not eligible. Also, rotating employees working at more than one project are not eligible unless they qualify as a full-time employee at one project.

Note: *The definition of full-time employment must be consistent with applicable federal and state law definitions of full-time employment, however in no event can it be less than 20 hours per week.*

(c) *The projected cost of employer contributions to be paid out of project funds may not exceed ten percent of the base pay of eligible employees.*
(d) *The employee is to be vested ownership of no less than 20% of the employer's contribution each year until fully vested. Employees must be fully vested after five full years of employment.*
(e) *Employees must remain 100% vested for all personal contributions to their account.*

(f) The actual cost of administering the retirement account plan will be prorated to the projects.

(g) No commingling of employee accounts may occur.

(h) The plan must be managed by a qualified outside entity with an established history of handling such programs.

(i) Agents will make modifications to the plan as necessary to comply with changes in the laws and regulations governing such programs.

To further the plan's goals, the agent may make modifications to the program without notice to HUD as long as the program continues to satisfy the provisions of paragraphs (a) through (i) above.

(3) Agents must certify to HUD that the retirement account plan meets the requirements set forth in this paragraph before any funds are charged to a project's operating account. addition, agents must include the additional cost in their Budgeted Rent Increase request.

6.39 MANAGEMENT COSTS PAID FROM THE MANAGEMENT FEE

116l

a. Expenses for services that are not front-line activities must be paid out of management fee funds, except for centralized accounting and computer services. Figure 6-2 above presents examples of costs that may only be paid out of the management fee.

b. Salaries, fringe benefits, office expenses, fees, and contract costs for the following activities must be paid out of management fee funds. These costs include:

(1) Designing procedures/systems to keep the project running smoothly and in conformity with HUD requirements.

(2) Preparing budgets required by the owner or HUD, exclusive of rent increase requests and MIO Plans.

(3) Recruiting, hiring, and supervising project personnel.

(4) Training for project personnel that exceeds the line item budget for training expenses.

(5) Monitoring project operations by visiting the project or analyzing project performance reports.

(6) Analyzing and solving project problems.

(7) Keeping the owner abreast of project operations.

(8) Overseeing investment of project funds.

(9) Ensuring that project positions are covered during vacations, sickness, and vacancies.

c. The salaries of agent supervisory personnel must be paid from the management fee unless one of the exceptions below is met.

(1) The cost of supervisory personnel providing oversight of centralized accounting and computer services for a project may be paid out of project funds.

(a) A prorated share of the salaries for such supervisors may be charged to the project's account.

(b) The total charges to a project for centralized accounting and computer services (including supervisory staff costs) provided by the agent may not exceed the cost of procuring comparable services from an independent contractor.

(2) The costs of the salary for a supervisory employee of the agent designated to replace a project employee on temporary leave may be paid out of project funds after the first 40 hours of the assignment.

(a) The amount paid out of project funds to cover the weekly salary of the replacement employee may not exceed the lesser of:

(i) Twice the amount of the absent employee's weekly salary; or

(ii) The actual amount of the replacement employee's weekly salary.

(b) Project funds may be used to pay the allowable portion of the replacement employee's salary for a period of up to 90 days after the first 40 consecutive hours.

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b. Determine whether the owner or the management agent has obtained a fidelity bond in accordance with chapter 2.14 of HUD Handbook 4381.5.
c. Determine whether hazard insurance has been obtained in the amount required by the project's mortgage.
d. Determine whether liability coverage is sufficient as determined by chapter 21 of HUD Handbook 4350.1.
e. Determine whether the owner or management agent has responded to all HUD management review reports, physical inspection reports, and inquiries regarding annual financial statements or monthly accounting reports within 30 days.
f. On a sample basis, test work orders and tenant complaints for timely follow up and compliance with management's procedures. Handbook 4381.5 states that whenever possible, owners/agents should take immediate action to address problems or concerns registered by the resident.
g. Determine whether the project is maintained in good repair and condition. If the units are subsidized, determine whether management's procedures ensure that units meet applicable housing quality standards.

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h. Inquire whether HUD, a contract administrator, or the lender has conducted routine unit and general property inspections. If findings were identified, determine whether corrective action was taken.
i. Question management and scan revenue accounts for any fees charged to the project or residents for additional services. Conduct followup or corroboration of management's responses as considered necessary to ensure that fees charged agree with the management agent certification or have been approved by HUD.

N. UNAUTHORIZED CHANGE OF OWNERSHIP/ACQUISITION OF LIABILITIES.

119

1. Compliance Requirements. Owners shall not, without the prior written consent of HUD, convey, assign, transfer, dispose of, or encumber any of the mortgaged property or permit the conveyance, transfer, or encumbrance of such property.

2. Suggested Audit Procedures.
   a. Question management about the existence of any agreements to sell, assign, dispose of, or encumber any of the mortgaged property or assets of or beneficial interest[4] in the property. Review any agreements. Determine whether HUD has approved transactions or is in the process of approving transactions and report any instances of noncompliance.
   b. Confirm all material liabilities listed on the client's balance sheet. Review for indications of change of ownership or additional encumbrances that may have been made without HUD approval.
   c. Report any other instances of unauthorized conveyance, assignment, transfer, disposal, or encumbrance of any of the mortgaged property or assets of or beneficial interest in the property identified during the course of the audit.

O. UNAUTHORIZED LOANS OF PROJECT FUNDS.

120

1. Compliance Requirements. Owners 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 for reasonable operating expenses and necessary repairs.
2. Suggested Audit Procedures.
   a. Question 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. Test accounts receivable to determine whether receivables are the result of routine operations and whether project funds have been loaned to the management agent, other projects, employees, or the owner.

120a

Favorite Compliance Findings Unauthorized Loans

- Definition: An unauthoritzed distribution that appears on the balance sheet as a receivable.
- Results in referral to either a HUD Field Office or the Enforcement Center and maybe to QASS as well

120b

HUD Takes an Extra Look at:

- Overpayments of management fees & distributions
- Advances
- Loans to employees or owners

[4] **Beneficial interest is generally the right to profits from an estate or property without owning the estate or property.**

- Loans to other projects or businesses

Looking at Receivables

121c

- What is the source of the receivable?
- OK if it's from a
  - Reserve release
  - Insurance settlement
  - Grant award
  - Lawsuit settlement
  - Vendor overpayment
- REAC tries to determine the reason from the Notes. Occasionally, they can.

It's Not OK if the Receivable is Due from:

120d

- Other projects or Businesses
- The management company
- Partners/Owners (unless it's from syndication or equity contribution)
- Any Related Party

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P. EXCESS INCOME.

1. Compliance Requirements. Owners of properties with mortgages insured under Section 236 of the National Housing Act must submit excess income within 10 days of the end of the month in which it was collected.
2. Suggested Audit Procedures.

a. Obtain copies of the monthly report of excess income, Form HUD-93094, for the period under review and any approval letters from HUD regarding retention of excess income.

b. Select a sample of the reports and determine whether the reports were prepared in accordance with HUD instructions.

c. For the sample items selected, determine whether the client remitted the full amount collected to HUD in accordance with HUD instructions and in a timely manner.

d. If excess income was not remitted to HUD, determine whether funds were retained in accordance with HUD approval and funds were used for the intended purpose.

122

Q. LEASED NURSING HOMES.

1. Compliance Requirements. Owners may enter into lease agreements to operate the facility, in which case the operator will be required to execute a regulatory agreement (HUD 92466-NHL) with HUD before the note is endorsed for insurance. The regulatory agreement requires lease payments to be sufficient to pay all mortgage payments including payments to reserves for taxes, insurance, etc., and payments to the reserve for replacements. If at the end of any fiscal year, payments under the lease have not been sufficient to pay for the above items, the owner and operator/lessee, upon request in writing from HUD, shall renegotiate the amounts due under the lease so that the lease payments shall be sufficient to pay for such items. In addition, the operator/lessee shall provide

HUD, within 30 days of request, a financial report, in a form satisfactory to HUD, covering the operations of the mortgaged property and of the project. The regulatory agreement also requires the operator/lessee to not sublease the project and maintain it in good repair. The owner's regulatory agreement requires the owner to make mortgage payments and reserve deposits. These responsibilities cannot be assigned.

2. Suggested Audit Procedures.
   a. Obtain a copy of the lease agreement, as may be amended, to operate the facility, if applicable, and the executed regulatory agreements (there will be one for the owner and one for the operator/lessee).
   b. Determine whether the owner received lease payments in a timely manner.
   c. Determine whether the total lease payments were adequate to cover the debt service (including tax and insurance escrows) and reserve for replacement deposits.
   d. Obtain maintenance logs, inspection reports, and other data to determine that the lessee has properly maintained the project. On a sample basis, review that documentation to determine whether the lessee made repairs to the project to properly maintain the property in accordance with housing quality standards. Visual inspection of the common areas and grounds should be made.
   e. Determine whether major changes have been made to the project without HUD approval.
   f. Determine whether the owner or operator/lessee complied with nondiscrimination, equal opportunity, or other requirements of state or local law or of HUD/FHA.
   g. Examine the terms of the lease to determine whether responsibility for making mortgage payments and reserve deposits has been assigned/delegated to the lessee. Verify that payments were made by the owner.

3-6. MARK-TO-MARKET PROGRAM (M2M).

123

In 1997, Congress established the Mark-to-Market Program (M2M) to help preserve the availability and affordability of low-income rental housing while reducing the cost to the federal government of rental assistance provided to low-income households using project-based Section 8 funds. Under this program, HUD resets the rents to the prevailing market level and restructures the property's mortgage debt, if needed, to permit a positive cash flow. The operations of M2M projects are to be audited using the steps in section 3-5 in addition to the following audit procedures. The auditor must obtain the business agreement and conform the requirements in that agreement to the audit steps in this section. Changes, as found necessary, should be made to the audit steps since these steps were established based on the M2M procedures stated in the M2M Program Operating Procedure Guide which may be different from those set forth in the Business Agreement.

124

A. Capital Recovery Payments for M2M Projects.

1. Compliance Requirements. In most M2M transactions, owners are required to invest new money either out-of-pocket or through borrowing. These funds cannot be provided through a loan secured by the project assets. In return, the owner receives capital recovery payments. These payments provide a market rate of return to owners on the new money invested and may only be collected when certain conditions are met. This requirement is not applicable to cooperatives.
2. Suggested Audit Procedures.
   a. Obtain a copy of the restructuring commitment and other restructuring documents to determine whether the owner invested new funds as required, including any new funds for reserves, repairs, transaction costs, or similar property costs.
   b. Obtain a copy of the source documents identifying the interest rate and payments period for the capital recovery payments. Obtain or **prepare an amortization schedule of the payments showing the amount advanced** for the restructuring, interest rate, and payment period. Determine whether the capital recovery payment is being paid as authorized over the applicable period of 7-10 years.
   c. Determine whether the terms and conditions of the capital recovery payments listed below were met on a monthly basis.
      (1) All expenses are paid, and there are no material accrued payables.
      (2) The first mortgage is current.
      (3) The property is in acceptable physical condition (the most recent REAC score is at least 60 or the multifamily HUB or program center has accepted the owner's proposal for curing a less favorable score).
      (4) There are no unresolved HUD audit or management findings, including any finding that the owner is not in compliance with the rehabilitation escrow deposit agreement.
      (5) The project's most recently issued audited financial statements reflected positive surplus cash, and any payables shown as due on the surplus cash schedule have been paid.
      (6) If funds are not available, payment will accrue until surplus cash becomes available. Interest is paid on the accrued amount.*

125

AHACPA Comment - Capital Recovery Payment (CRP)
In the AFS, the owner's investment (on which the CRPs provide a return) is treated as a loan, with the interest rate and term determined in the M2M underwriting. Each monthly payment is treated as having principal and interest portions.

*CRP is made in monthly payments **from property funds** to the owner as earned, assuming all preconditions are met, including that all Project expenses are paid.*

Amounts are generally listed as "per month". In the AFS, the owner's investment (on which the CRPs provide a return) is treated as a loan, with the interest rate and term determined in the M2M underwriting. In certain instances interest must be imputed to correctly calculate the amortization of principal and interest. Each monthly payment is treated as having principal and interest portions.

126

Accrued and unpaid CRP should be listed as an obligation on the Surplus Cash calculation; there is no surplus cash until those have been covered. At the end of a fiscal year, the loan will have a remaining principal balance (some of which is to be paid within twelve months and is reflected as a current liability reflected in FASS account 2179, with the balance being a long term liability reflected in FASS account 2329). If any payments have become due but have not been paid as of fiscal year end, there will also be accrued interest payable, which should be shown in FASS account 2139 - Accrued Interest Payable - Capital Recovery Payment (M2M). Interest charged during the year is recorded in account 6845. ***Note, however, that no additional interest may be accrued because of the delay in payment.***

127

If, as of the FYE date, the pre-conditions for payment of these CRP installments have been satisfied, reflect the unpaid installments as obligations on the Surplus Cash schedule. Otherwise, do not reflect the unpaid installments as obligations on the Surplus Cash schedule.

CRP payments during a fiscal year are reported on the Statement of Cash Flows in FASS accounts S1200-417 (principal portion) and S1200-195 (interest portion).

The current principal portion of the CRP (FASS account 2179) would include principal payments due within the next twelve months ***and*** *the principal portion of any back payments that the owner was unable to pay due to the preconditions not being met.*

In the ***Computation of Surplus Cash****, CRP payments that are due but that have not been paid may be included as Other Obligations only if, as of fiscal year end, the preconditions for payment had been satisfied.*

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B. Incentive Performance Fee for M2M Projects.

1. Compliance Requirements. The incentive performance fee is provided to recognize owner equity and as an incentive for demonstrating operating efficiencies. This fee is a percentage, generally 3 percent, of annual effective gross income with a floor of $100 and a ceiling of $200 per unit per year. The owner can collect this payment annually if certain conditions are met. The percentage can be increased or decreased by the participating administrative entity to establish a fee within the maximum and minimum limitations.
2. Suggested Audit Procedures.
   a. Obtain a copy of the restructuring commitment and other restructuring documents and determine the incentive performance fee percentage.
   b. Determine whether the terms and conditions of payment listed below were met for the annual period during which the owner collected the incentive performance fee.
      (1) All expenses are paid, and there are no material accrued payables.
      (2) The first mortgage is current.

(3) The property is in acceptable physical condition (the most recent REAC score is at least 60 or the multifamily HUB or program center has accepted the owner's proposal for curing a less favorable score).
(4) There are no unresolved HUD audit or management findings, including any finding that the owner is not in compliance with the rehabilitation escrow deposit agreement.
(5) Only funds available after payment of the expenses, debt service on any first mortgage, and any capital recovery *payment were used. If funds are not available, payment cannot accrue.

AHACPA Comment - Incentive Performance Fee

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The IPF is calculated based on the Effective Gross Income for the period beginning the day after the M2M closing and continuing through year-end. Owners who claim an IPF for the partial year in which the M2M closing occurs must include a computation of partial year Effective Gross Income (EGI) in the notes to the audited financial statements.

Effective Gross Income is:

- *Gross Potential Rents (FASS account 5100T Total Rent Revenue, but excluding FASS accounts 5180 Flexible Subsidy Revenue and FASS account 5191 Excess Rents);*
- *Minus Vacancy and Bad Debt (FASS account 5200T Total Vacancies plus FASS account 6370 Bad Debt)*
- *Plus Other Income (FASS account 5900T Total Other Revenue, but excluding FASS account 5945 Interest Reduction Payments Revenue).*

Note: FASS account 5400T Total Financial Revenue is not included in EGI because these line items were not included in the M2M underwriting and because (for the most part) this represents interest income on the Reserve for Replacements that is not available for operations.

130

The IPF should be shown as an expense on the Profit and Loss Statement (FASS 7115) and as an accrued liability on the balance sheet (FASS 2190 Miscellaneous Current Liabilities). IPF is not shown as an <u>obligation</u> on the Surplus Cash schedule; instead, the IPF is <u>calculated</u> on the Surplus Cash schedule (FASS S1300-203).

It is not acceptable to setup an account payable and include IPF as an obligation on the surplus cash calculation. Owners MUST either take the distribution or deposits funds into a separate entity cash account

131

Preconditions must be met to pay both CRP and IPF. The following paraphrases the Regulatory Agreement Rider; see the Rider for the exact wording ***(See Preconditions Letter from Ted Toon 05/05/2005):***

a. all project expenses have been paid, (including accrued payables for which payment is due form the previous year's financial statements),
b. There are no outstanding sums due under the either the First Mortgage or, if applicable, Priority Cash Flow Indebtedness;
c. the most recent REAC physical inspection score is 60 or above (unless Owner and HUD have mutually agreed to Owner's proposal to cure deficient mortgaged property conditions;
d. there are no outstanding HUD audit or management findings; and
e. the owner is not in default under any of the key governing documents such as the Regulatory Agreement.

As noted elsewhere, in addition to these general performance and compliance criteria, IPF is earned and paid only from positive Surplus cash.

Per the 2005 preconditions letter, it is HUD's position that Surplus cash is a precondition to the payment of CRP.

IPF is payable to the owner at the end of the accounting year, assuming all preconditions have been met. None of these payments require explicit permission in advance from HUD.

132

C. <u>Distribution of Surplus Cash for M2M Projects</u>.

1. <u>Compliance Requirements</u>. After payment of all operating expenses, debt service on any first mortgage, any capital recovery payment, and the incentive performance fee, the owner will receive up to 25 percent of the remaining surplus cash annually. The remainder of surplus cash will be paid toward the M2M second (or third) mortgage. Since requirements in the Business Agreements my vary from the procedures contained in the M2M Program Operating Procedure Guide which were used to establish the audit steps listed below, the auditor must obtain a copy of the Business Agreement and compare it to the audit guide steps and make the changes deemed appropriate,

2. <u>Suggested Audit Procedures</u>.
   a. Obtain a copy of the restructuring commitment and other restructuring documents and determine the requirements and/or restrictions that exist for the capital recovery payment, the incentive performance fee, and the M2M (surplus cash) note payment and distributions
   b. Review the prior-year surplus cash computation and note that the owner distribution does not exceed 25 percent of the surplus cash available for distribution or the percentage determined by Office of Affordable Housing Preservation.
   c. Determine that the M2M (surplus cash) note payment and distributions were paid after all required payments were made and that the capital

recovery payment and incentive performance fee were properly made as determined in audit steps 3-6.A and 3-6.B.

Mortgage Restructuring Note/Contingent Repayment Note

133 *Any MRN / CRN principal balance that is to be paid from current Surplus Cash should be shown as a short term obligation in the AFS (FASS account 2172 Other Mortgages Payable Short Term). The long term portion of the unpaid principal balance of MRN / CRN should be reflected in the AFS (FASS account 2232). The accrued interest on the MRN / CRN should be shown in FASS account 2132 -Accrued Interest Payable - Other mortgages.*

134 *MRN/CRN payments must be segregated from all other debt payments, in the Statement of Cash Flows. The following FASS accounts should be used to reflect m2M debt:*

- *(MRN Principal Payments) S1200-361 Principal Payments - Second Mortgage*
- *(MRN Interest Payments) S1200-181 Interest Payments - Second Mortgage*
- *(CRN Principal Payments) S1200-362 Principal Payments - Third Mortgage*
- *(CRN Interest Payments) S1200-182 Interest Payments - Third Mortgage*

If the MRN/CRN is in first lien position, please do not use the FASS accounts for first mortgage payments to reflect MRN/CRN payments. Rather, use the FASS accounts identified above (regardless of lien position).

If it is not possible to dedicate the above-mentioned FASS accounts solely for MRN/CRN payments, owners should use a reporting approach that separately identifies payments made toward the MRN/CRN (for example, detailing MRN/CRN payments in a footnote).

135 *MRN or CRN payments are due within 10 days of the AFS due date. The mailing address is included in each MRN and CRN.*

Payments by regular mail *should be payable to FHA, and sent with a transmittal letter identifying the project name, FHA number and how funds are to be applied to the Atlanta payment lockbox at:*

HUD - Multifamily Mortgage Notes
PO Box 530256
Atlanta, GA 30353-0256

Overnight deliveries should send payments with a transmittal which includes the entire address below, in addition to the project name, FHA number, and how funds are to be applied to the following address:

Bank of America (530256)
C/O HUD Multifamily Mortgage Note Collections
GA5-005-02-10 1075 Loop Road
Atlanta, GA 30337

Surplus Cash

136 *The surplus cash calculation must recognize, the payment of Capital Recovery Payments, payment of Incentive Performance Fees, and/or payments on the*

Mortgage Restructuring Note / Contingent Repayment Note must be reflected in the Statement of Changes in Financial Condition in the audited financial statements for the year in which payment was made. In addition:

- *Any CRPs that were due but not paid as of year-end (for example, because the REAC physical inspection score was too low) must be reflected as liabilities on the balance sheet.*
- *Any IPF that was earned for the year (to be paid to the Owner in cash after completion of the audited financial statements) must be reflected as an expense on the Profit and Loss Statement.*
- *The proposed distribution of positive year-end Surplus Cash must be reflected on Part B of the Surplus Cash Schedule in the audited financial statements.*

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Consequences of Negative Surplus Cash

If the client has negative surplus cash, no Incentive Performance Fee (IPF) is earned, accrued, or paid to the Owner for the year just ended. No payment is due under the Mortgage Restructuring Note (MRN) or Contingent Repayment Note (CRN) for that year. Finally, it is possible that the property may not meet the preconditions for continued payment of Capital Recovery Payments (CRPs).

Timing of Distribution of Surplus Cash

*****For a property that completed a M2M debt restructure transaction, Surplus Cash cannot be distributed until after the AFS is filed.**** *Also, Surplus Cash cannot be distributed until all other requirements have been satisfied (for example, the Incentive Performance Fee cannot be earned or paid unless certain preconditions have been satisfied.* ***That is, the December 31, 2005 Surplus Cash cannot be distributed until the spring of 2006 at the earliest. Mid-year distributions are not allowed for post-M2M projects.***

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Corrections of Surplus Cash

Going forward, you will receive a demand letter from HUD if the annual M2M payment amount reflected in your project's annual financial statement has not been paid within 30 days of the filing date. That delinquent amount will also appear on your next monthly billing statement from HUD's servicer for these Notes, DynAccSys.

HUD's PCPM Contractor is currently performing in-depth analyses of AFSs for HUD for all years since M2M closing. The results of those analyses and any adjustments necessitated by their findings will be communicated to you in writing with a detailed explanation of HUD's analysis. That process requires input from the HUD PM and owners and thus is/has been very time intensive. All payments due, and all payments received to date, will be reconciled and reflected on your monthly billing statement (sent monthly to the project owner or managing agent by HUD's servicer for these Demo Notes, DynAccSys).

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If an error is made in the Computation of Surplus HUD does not require you to amend or re-file the prior year AFS, in fact HUD discourages you from doing so. The owner should submit a revised Computation of Surplus Cash

in hard copy form to the HUD Project Manager(PM). The revised Computation of Surplus Cash should also be entered in the footnotes of the project's next AFS along with an explanation as to why the revised calculation was required. That footnote should identify and summarize all such correspondence from HUD and/or HUD's contractors regarding adjustments to prior year AFS, whether or not they resulted in additional payments to HUD on the M2M debt. This is applicable whether or not the payment amount on the MRN changes.

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D. Special Rules for Cooperatives.

1. Compliance Requirements. For cooperatives, additional requirements are included in the audit procedures listed below. The compliance requirements in 3-6.B and 3-6.C also apply to cooperatives. Capital recovery payments listed in 3-6.A do not apply.
2. Suggested Audit Procedures.
   a. Obtain a copy of the restructuring commitment and other restructuring documents and note the additional operating reserve requirement.
   b. Determine whether the cooperative is in compliance with the annual escrow deposit of 3 percent of annual operating expenses plus principal and interest and mortgage insurance premium.
   c. Determine whether the surplus cash and the incentive performance fee of the cooperative were deposited in a separate residual receipts account.
   d. Determine whether withdrawals from the residual receipts account for the period under audit were approved by the multifamily HUB or program center director and were used for the purpose requested.

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M2M Footnote Disclosures

HUD and its servicer find supplemental information very valuable in understanding the accounting treatments. Such information may forestall questions and accountants are encouraged to make use of the opportunity to provide explanations.

Accountants are asked to make use of footnotes regarding CRPs, including the M2M closing date, the original amount of the owner's investment, the interest rate, the number of payments, and the payment amount. The footnote should also note the number of payments that have come due, the number of payments that were made during the fiscal year, and the total number of payments that have been made (from the M2M closing through the end of the fiscal year).

HUD and its contractors find supplemental footnote information in the annual financial statement filings very valuable in understanding underlying calculations and accounting treatment of M2M items. Accountants are strongly encouraged to make use of footnotes in the AFS for all projects. For projects closed prior to 2000 in the Portfolio Reengineering Program Demonstration program, explanations of the calculation of "Net Cash" are very helpful in reconciling Notes payments.

HUD Reviews of M2M Data

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If a financial review by HUD concludes that CRP and/or IPF were paid when preconditions had not been met, any improperly distributed amounts will have to be repaid to the project accounts, which will increase the Surplus Cash and resulting payments due on the Mortgage Restructuring Note. The owner will be invoiced for any amounts due on the Note that result from such a review and recalculation, and these amounts become due and payable when invoiced. An adjusted computation of Surplus Cash must be included in the following year's AFS (do not re-file the AFS for the year in question).

HUD currently performs two reviews on M2M submissions. The first is performed by the REAC system, analyst and the PM. The second is performed for OAHP's contractor. The two reviews focus on distinct aspects of the AFS, and are therefore not redundant in scope. You may receive correspondence regarding one or both reviews, and the controlling legal documents require your cooperation with both. The Surplus Cash analysis is specifically focused on protecting the value of the M2M portfolio. Either the HUD PM, or the PCPM (at the HUD PM's direction) may contact you regarding the analysis.

Representatives from HUD contractors may directly contact a property owner only when expressly directed to do so by HUD. RER Solutions, Inc. (and its subcontractor Value Recovery Group), have been retained as OAHP's portfolio management advisor, responsible for financial review and analysis of projects to ensure appropriate calculation of Surplus Cash and subsequent MRN and CRN payments.

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Common errors found in these reviews include:

a. In the Statement of Cash Flows, not recording CRP payments correctly. The correct FASS accounts are:

- *S1200-417 Principal Payments on Capital Recovery Payment (M2M)*
- *S1200-195 Interest on Capital Recovery Payment (M2M) (see 2005 Letter question #7)*

b. Showing the current year Incentive Performance Fee (IPF) as an obligation on the Surplus Cash schedule (see the 2004 Letter, question #7, for how to correctly reflect IPF).

c. In the Statement of Cash Flows, not recording IPF payments correctly. The correct FASS account is S1200-223 Entity - Incentive Performance Fee.

d. In the Statement of Cash Flows, not recording payment of the cash flow "split" from the prior year's Surplus Cash correctly. The correct FASS account is S1200-420 Distributions for the owner portion of the split.

3-7. SECTION 236 DECOUPLING PROJECTS.

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1. Compliance Requirements. As a condition for receiving continued interest reduction payments (IRP) under section 236(e)(2) and section 236(b), the owner agrees to operate the project in accordance with all low-income affordability restrictions for the period identified by the use agreement.
2. Suggested Audit Procedures.

a. Obtain a copy of the applicable IRP agreement, any use agreements, and Housing Notice 00-8, *Guidelines for Continuation of Interest Reduction Payments after Refinancing*, and related notices for reinstatement and extension.

b. On a sample basis, review tenant files and ensure that the owner is in compliance with the low-income affordability restrictions for the period covered by the IRP and use agreements.