





Most Frequently Asked Questions about Auditing HUD Multifamily Housing Entities and Other HUD Activities

November 12, 2014



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What will we cover

- ▶ A summary of recent HUD program activity
- ▶ The latest on the HUD Consolidated Audit Guide (HUD Guide), including an update on the recently overhauled chapter 4 titled, *Mortgage Insurance for Hospitals Program*
- ▶ Planning considerations for 12/31/14 year-end audits
- ▶ Frequently Asked Questions (FAQs) about HUD audits and other related matters

Recent HUD Program Activity



Recent HUD Program Activity – Multifamily

- ▶ 2014 version of Regulatory Agreement
- ▶ Update on Surplus Cash Computation
- ▶ Financial Assessment Subsystem - Multifamily Housing (FASSUB) System Releases (December 2013 and May 2014)
- ▶ Revised Industry User Guide for FASSUB
- ▶ Housing Notice H2013-23, *Change in Annual Financial Statement (AFS) Submission Requirements for some Multifamily Housing Projects* (Housing Notice H2013-23)
- ▶ Office of Residential Care Facilities – Final Reporting Requirements Published October 3, 2014

2014 Version of Multifamily Regulatory Agreement

- ▶ Revised agreement updates the previous 2011 agreement
- ▶ Effective for all new commitments issued after June 2014
- ▶ Incorporates provisions in HUD Handbooks and Housing Notices
- ▶ Most significant change is revision in surplus cash calculation (see next slide)

Update on Surplus Cash Computation

- ▶ The HUD entity is required to include all items paid in the 1st mortgage payment following the end of the fiscal period
- ▶ If a mid-year calculation is permitted, includes all items paid in the 7th month mortgage payment
- ▶ Such items include: principal, interest, mortgage insurance premium deposits, deposits to the reserve for replacements and other reserves required by HUD, tax and insurance escrow deposits

Update on Surplus Cash Computation

- ▶ **With the issuance of the 2014 Multifamily Regulatory Agreement HUD has established 3 separate calculations of surplus cash**
 - The original calculation which included only interest from the next mortgage payment (issued before late 2011)
 - The 2011 Regulatory Agreement which included principal, interest, and reserves from the next month's mortgage payment.
 - 2014 Regulatory Agreement which includes ALL items from the first payment following the month of the surplus cash calculation

FAQs - Change in Surplus Cash Definition

- ▶ **Does the change in surplus cash definition apply to section 232 HUD-insured mortgages?**
- ▶ **I have a client that is a HUD-insured loan owned by a nonprofit entity that refinanced their loan last fall and signed a new Multifamily Regulatory Agreement (HUD-92466M). Does the agreement apply to both nonprofit and for-profit projects?**
- ▶ **Does the surplus cash calculation liability section change include “the 1st month following payment” only for properties with a new regulatory agreement? Or do all entities have to implement the change?**

FAQs - Change in Surplus Cash Definition

- ▶ **The definition in the Multifamily Regulatory Agreement is not specific as to which items apply and indicates it is for note amounts due on the 1st day of the month following the end of the fiscal period. How much latitude do project owners have in this matter?**

FAQs - Change in Surplus Cash Definition

- ▶ **If a project has been refinanced within HUD, after September 1, 2011, do they have a new Multifamily Regulatory Agreement and are they required to follow the new surplus cash definition?**
- ▶ **Any guidance on how to rectify the situation where the new Surplus Cash Computation requirement was inadvertently not used in 2012?**

FASSUB System Release – December 2013

- ▶ **New fields for changes relating to revisions to Chapters 1 and 2 of HUD Guide**
 - Independent Auditor's Report on Internal Control and Compliance in Accordance with *Government Auditing Standards* (S2200)
 - Major Program Compliance Report now contains internal control over compliance (S2300)
 - Fair Housing and Nondiscrimination Report removed
 - Field added for Management Letter comments related to nonmaterial noncompliance (S2400)
 - The Schedule of Findings has new fields related to the finding resolution status and the required sampling disclosures (information on universe and population size, sample size, number of instances of noncompliance) (S2700)
 - Fields related to the disclosure of the client's Corrective Action Plan (S2700)

FASSUB System Release – May 2014

- ▶ Updated the *Schedule of the Status of Prior Audit Findings*.
- ▶ Accounts S2800-005 (Previous Finding Reference Number) and S2800-030 (Report Period) eliminated
- ▶ Account S2800-020 (Narrative) renamed to "Finding."
- ▶ Account S2800-020 (Status) will be reconfigured to be a text field instead of a drop-down box.
- ▶ Active submissions with a status of "Validated" or "CPA Attested" were reverted back to a draft status on May 30, 2014 and will need to be re-validated with the new account changes
- ▶ These changes only affect profit-motivated/limited-distribution owners filing in accordance with the HUD Guide

FASSUB System Errors – Multifamily

▶ Validation Errors for Accounts S2100-030 and S3400-030

Account Number	Rejection Reason
S2100-030	If account S2100-020 is valued as Qualified, Disclaimer, or Adverse, then either this account or account S2700-005 is required.
S2700-005	If account S2100-020 is valued as Qualified, Disclaimer, or Adverse, then either this account or account S2100-030 is required.

- ▶ To correct these errors please instruct users to enter "Not applicable" in account S2100-030.

For OMB A133 submissions users are getting similar errors but the account number is S3400-030. Again the workaround is to enter "Not applicable" in account S3400-030 and this will clear the validation errors.

Revised Industry User Guide for FASSUB

- ▶ Appendix B updated February 2014 for Housing Notice H2013-23 which allows owners receiving less than \$500,000 to submit owner-certified financial statements

Housing Notice H2013-23

- ▶ On August 8, 2014, HUD issued Housing Notice H2013-23
- ▶ The purpose of the Notice is to eliminate the audit requirement for “small projects” (combined federal assistance is less than \$500,000)
- ▶ Effective for the fiscal year ending December 31, 2013

FAQs – Housing Notice H2013-23

- ▶ Does Housing Notice H2013-23 apply to mark-to-market properties under the \$500,000 requirement?
- ▶ Does it apply to nonprofit entities as well as to for-profit entities?

FAQs – Housing Notice H2013-23

- ▶ **Consider a situation where there are 10 projects with individual HUD project numbers.**
 - These projects individually receive less than 500,000 in federal assistance.
 - The projects are owned by a partnership, but the individual projects are for-profit.
 - The 10 projects have individual audits but the financial statements and REAC input have been done as a consolidated entry.
- ▶ **Can these 10 projects now be alleviated from the HUD audit requirement and be input into REAC on an "owner-certified" basis?**

Office of Residential Care Facilities

- ▶ **Final reporting requirements published October 3, 2014**
- ▶ **ALL operators must submit their operator financial reports to the lender that services the Federal Housing Administration (FHA) insured mortgage for fiscal years commencing on or after December 2, 2014**

Recent HUD Program Activity – Lenders

- ▶ **Lender Electronic Assessment Portal (LEAP) is a new system that is a one-stop shop for all Lender Approval and Recertification activities**
 - Lenders use LEAP to manage Institution and Branch information and lender profile functions like Cash Flow account setup
 - LEAP replaces the current “Lender Approval” and “Cash Flow” web pages on FHA Connection
 - LEAP replaces the Lender Assessment Subsystem (LASS) for submission of financial information as part of the Recertification process
- ▶ **Lenders access LEAP through FHA Connection using a single sign-on process.**
- ▶ **LEAP went live May 27, 2014**
- ▶ **Visit HUD LEAP page for updates**
http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/lender/SFH_Lenders_LEAP

Recent HUD Program Activity - Government National Mortgage Association (Ginnie Mae)

- ▶ **All Participant Memorandums (APM) 14-16: New Issuer Net Worth and Liquidity Requirements**
 - **Single-Family Issuer Minimum Net Worth:** minimum adjusted net worth requirement of \$2,500,000 plus 0.20% of the Issuer's total effective outstanding Single-Family obligations will be increased to \$2,500,000 plus 0.35% of the Issuer's total effective outstanding Single-Family obligations.
 - **Single-Family Issuer Minimum Liquidity:** requirement of 20% of required net worth will be changed to the greater of \$1,000,000 or 0.10% of the Issuer's outstanding Single-Family securities.
 - **Issuers Approved for more than one Program Minimum Net Worth and Liquidity:** minimum adjusted net worth and liquid assets requirement equal to or greater than the sum of the minimum requirements for all the program types in which the Issuer is approved to participate, as opposed to the highest program requirement.

APM 14-16, Effective Dates

- ▶ Beginning January 1, 2015, applicants seeking Issuer approval will be required to meet the new requirements.
- ▶ Issuers approved on or before December 31, 2014, will be required to meet the new requirements beginning December 31, 2015.
- ▶ Beginning January 1, 2015, in order for a mortgage-servicing rights (MSRs) bulk transfer, or “a transfer of Issuer responsibilities,” to be approved by Ginnie Mae, the acquiring Issuer will have to meet the new requirements.
- ▶ Beginning January 1, 2015, in order for a new Pool Issuance for Immediate Transfer (PIIT), or MSR bulk transfer, arrangement to be approved by Ginnie Mae, the acquiring Issuer will have to meet the new requirements.

Latest on HUD Guide



Chapter 1, *General Audit Guidance*

▶ Last update in May 2013

▶ Reminders

- HUD Guide mandatory for audits of all for-profit participants
- Auditors of entities with HUD programs covered in chapters 3 through 7 but subject to OMB Circular A-133 should use the compliance requirements and suggested audit procedures only for purposes of building an audit program per Part 7 of the OMB Circular A-133 Compliance Supplement (Supplement) for HUD programs that are not included in the Supplement
- Audit sampling requirements in chapter 1
- Major program thresholds and related guidance in chapter 1 (see next slide)
- Retain audit documentation for a minimum of 6 years
- Withdrawal or termination after audit is initiated requires auditor to advise the Office of Inspector General Single Audit Coordinator

Chapter 1, Major Programs

- ▶ Chapter 3 – \$500,000 (including HUD-insured or HUD-guaranteed loan balance equal to or exceeding \$500,00 as of the end of the audit period)
- ▶ Chapter 4 - \$500,000 (including HUD-insured or HUD-guaranteed loan balance equal to or exceeding \$500,00 as of the end of the audit period)
- ▶ Chapter 5: No major program designation is needed.

Chapter 1, Major Programs

- ▶ **Chapter 6: Major if the issuer had a servicing portfolio or had any remaining principal balance at the end of the audit period.**
- ▶ **Chapter 7**
 - Major regardless of the amount of loans originated or serviced during the period under audit.
 - Lenders having combined originations and a servicing portfolio of less than \$2 million, the opinion on compliance need cover only the compliance requirements in chapter 7, section 7-5(A), Quality Control Plan, and 7-5(G), Lender Annual Recertification, Adjusted Net Worth, Liquidity, and Licensing.

FAQs – Chapter 1 – Audit Scope

- ▶ **For projects that have a HUD mortgage over \$500,000 and Section 8 subsidy under \$500,000 is the auditor only required to audit the mortgage for compliance?**
- ▶ **If so, what compliance requirements are applicable to the mortgage program? For example would testing of tenant files still be required?**

FAQs – Chapter 1 – Audit Scope

- ▶ Consider a multifamily entity that has over \$500,000 in federal (HUD) assistance, but each program is less than \$500,000 (i.e., no major programs).
- ▶ What is the extent of testing required? And is it correct to assume that the auditor would replace the compliance report on major programs in FASSUB with a statement that it is not applicable to this engagement?
- ▶ If a project has less than \$500,000 of Section 8 that is a Low Income Housing Tax Credit with a mortgage issued by a state agency but requires a REAC filing are we required to issue reports on compliance?

FAQs - Chapter 1 - Sampling

- ▶ What sampling guidance should be followed? Are there any minimum sample sizes?
- ▶ Are you allowed to do dual-purpose testing?

Chapter 2 - Reporting

▶ Last update January 2013

▶ Reminders

- Nonmajor reporting eliminated
- Separate reporting on fair housing and nondiscrimination eliminated
- Report formats revised to be more consistent with OMB Circular A-133 reporting framework
- Format changes to Schedule of Findings, Questioned Costs and Recommendations

FAQs - Chapter 2 - Reporting

- ▶ **Our client is a nonprofit entity that has a HUD-insured mortgage loan greater than \$500,000 so it is subject to an OMB Circular A-133 audit. Should we use the report wording in the report illustrations of Chapter 2 of the HUD Guide or should we use the report wording from AICPA illustrations for OMB Circular A-133 audits?**

FAQs – Chapter 2 - Reporting

- ▶ Are management letters that do not include material weaknesses or significant deficiencies required to be submitted to HUD?

FAQs – Chapter 2 - Reporting

- ▶ If an Management and Occupancy Report (MOR) has 25 findings, do these need to be reported separately as prior findings or can the MOR be summarized?
- ▶ Do all significant deficiencies have to be reported as findings?
- ▶ Due to it's unique character, it does not seem that a Minimum Background Investigation (MBI) letter to the owner would need to be considered a prior audit finding. Is this a correct interpretation?
- ▶ If the entity had a monitoring review in the current year, and that monitoring review had findings, is the auditor required to report that as a finding?

Chapter 3, HUD Multifamily Housing Programs

▶ Last updated July 2008

▶ Reminders

- Be aware of chapter 1 and 2 changes that impact chapter 3 engagements
- Chapter 3 includes “group project-based sampling” of certain areas when conditions are met

Chapter 3 - FAQs

- ▶ **Can you address how auditors should sample when they have multiple HUD projects (separate entities) at same management company. Do they still need to follow the same sampling standards, or can they spread this across the total population of projects, etc.?**
- ▶ **Is there a requirement that there be a minimum of 4 projects being audited under a single system to use group project based sampling?**

Chapter 3 - Group Project-Based Sampling Refresher

- ▶ Exceptions for testing when project is owned and/or managed by an entity that owns and/or manages multiple HUD/FHA assisted projects
- ▶ Compliance sections - Tenant Application, Eligibility, and Recertification; Tenant Security Deposits and Management Functions
- ▶ All other compliance sections except for the three cited above must be performed on each project

Chapter 3 - Group Project-Based Sampling Conditions Refresher

- ▶ Same system is used by management for the compliance section for all projects
- ▶ Projects have the same supervisor, procedures followed are identical and the test of internal controls did not disclose any weaknesses
- ▶ Owner agrees to the project-based sample method (signed agreement – i.e., engagement letter)
- ▶ Auditor fully documents all the above

Chapter 3 - Group Project-Based Sampling Refresher

▶ What is meant by “same supervisor?”

- The person that
 - Directly responsible to get the related work accomplished or in charge of the function
 - Gets work accomplished through staff who reports the results to the individual that is ultimately responsible for accomplishing the function
 - Can be at the project, regional or corporate office

Chapter 3 - Group Project-Based Sampling Refresher

▶ Minimum Sampling Requirements

- At least 20% of the projects
- No less than a minimum of four projects each year
- Each project reviewed at least every five years or less

▶ If the auditor elects to do the five-year sampling plan, the sampling schedule and system for selecting must be included in the work papers

Chapter 3 - Group Project-Based Sampling Refresher

- ▶ If a condition is noted that is to be reported in a finding or management letter, it must be reported in all reports
- ▶ Opinion on compliance provided for each individual project; testing must support the opinion for each individual project and not the group as a whole

NEW! Chapter 4, *Mortgage Insurance for Hospitals Program*

- ▶ Do you audit profit-motivated or limited-distribution entities participating as mortgagors in HUD's FHA Mortgage Insurance for Hospitals Program?
- ▶ If so, you should be aware that HUD recently issued updated audit requirements in Chapter 4 of the HUD Guide!
- ▶ Chapter effective for audits of entities with fiscal years ending on or after December 31, 2014; early implementation encouraged
- ▶ To be used in conjunction with chapters 1 and 2 of HUD Guide

Chapter 4, *Mortgage Insurance for Hospitals Program*

- ▶ Complete overhaul of the chapter (last update was 2008)
- ▶ Addresses inconsistencies that had been in previous Chapter 4 with the most recent versions of Chapters 1 and 2
- ▶ Revised for 2011 Revision *Government Auditing Standards* and clarified auditing standards
- ▶ Also reflects various regulatory changes and HUD program financial operations and accounting Handbook changes

Chapter 4 - Terms

- ▶ **Mortgagor term redefined -**

“the borrower and its successors and affiliates under the HUD-insured mortgage, to the extent that its assets, liabilities, net assets, revenues, and expenses are encumbered by the mortgage and the security agreement, including without limitation leased equipment for the benefit of the hospital and restricted assets.”

- ▶ **Mortgagor in chapter 4 refers to the new term and the previously used term “mortgaged entity”**

Chapter 4, Compliance Requirements

- ▶ Federal Financial Reports
- ▶ Mortgage Status
- ▶ Mortgage Reserve Fund, Equipment Replacement Reserve Fund, and Special Escrows
- ▶ Distributions to Owners or Affiliates
- ▶ Equity Skimming
- ▶ Cash Receipts
- ▶ Cash Disbursements
- ▶ Unauthorized Change of Ownership/Mergers/Acquisitions, and Liabilities
- ▶ Unauthorized Loans or Loan Guarantees of Project Funds
- ▶ Acquisition of Real Property and Personalty
- ▶ Budget
- ▶ Financial Monitoring by the Board
- ▶ Additional Indebtedness
- ▶ Minimum Account Presentation
- ▶ Ratios
- ▶ Cost Certification and Final Endorsement
- ▶ Other Conditions

Chapter 4, Reporting Requirements

- ▶ List of reference materials
- ▶ Reporting requirements – audited financial statements due within 120 days after fiscal year end
- ▶ In-relation-to opinion on supplemental information required by HUD
- ▶ Additional reports required by chapter 2
- ▶ Audit finding reporting
- ▶ Hard copy of reporting package to Office of Hospital Facilities

FAQ – Chapter 4

- ▶ **My firm also audits entities subject to OMB Circular A-133 that get HUD money under CFDA #14.128 which is the Mortgage Insurance for Hospitals Program. CFDA #14.128 does not have a separate program section in Part 4 of the OMB Compliance Supplement. Should I just use the HUD Guide?**

Chapter 5, *Development Cost Certification Audit Guidance*

- ▶ **Last updated March 2007**
- ▶ **Reminders**
 - Provides guidance to for-profit mortgagors for the audit of development cost certifications.
 - Cost certification is basis for HUD's determination of the project's actual development cost and/or maximum insurable mortgage
 - Necessary before the project may proceed to final formal endorsement
 - Cost certification must be in the HUD field office 30 days before final endorsement/closing
 - Submitted in hard-copy format to HUD field office
 - Not required to be electronically submitted through REAC

FAQs – Chapter 5

- ▶ **What compliance testing areas need to be addressed?**
 - Compliance requirements and audit areas listed in chapter 5
 - Federal Financial Reports
 - Accounting System
 - Cutoff Timing and Eligibility of Costs
 - Identity of Interest

Chapter 6, *Ginnie Mae Issuers of Mortgage-Backed Securities Audit Guidance*

- ▶ **Last updated April 2013 (electronic reporting requirements added)**
- ▶ **Prior update – May 2012 (significant changes)**
- ▶ **Chapter not updated yet for new net worth and liquidity requirements in APM 14-16 (covered with Ginnie Mae program changes in previous slides)**

Chapter 7, *FHA-Approved Lenders Audit Guidance*

▶ **Last updated December 2012**

▶ **Reminders**

- Applies to supervised and nonsupervised lenders
- Title I and Title II lender compliance requirements included

Planning Considerations for December 31, 2014 Year-end Audits



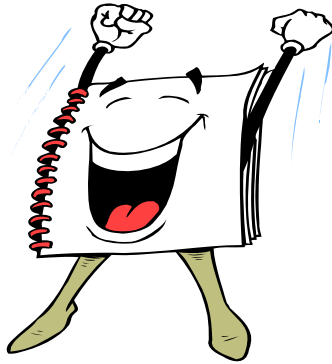
Planning Considerations

- ▶ **Ensure familiarity with program requirement changes discussed earlier in presentation**
- ▶ **Review HUD audit requirements including major program determination in chapter 1 of HUD Guide**
- ▶ **Review *Government Auditing Standards (GAS)* CPE and independence requirements (along with AICPA independence requirements) to ensure compliance**
- ▶ **Ensure that engagement letters meet the requirements in chapter 1 of HUD Guide**

Planning Considerations (continued)

- ▶ **Review reporting requirements in chapter 2 of HUD Guide applicable to entity**
- ▶ **Make sure you review the most recent Regulatory Agreement for your client**
- ▶ **Review communications from HUD to your client**
- ▶ **If auditing entities that participate in the FHA Mortgage Insurance for Hospitals Program, need to become familiar with new Chapter 4 requirements**

Questions ?????



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