

U.S. Department of Housing and Urban Development
Office of the Inspector General

SPECIAL ATTENTION OF:

TRANSMITTAL

Title II and I Mortgagees, Lenders,
Loan Correspondents, Loan Management
Branch Chiefs, Ginnie Mae Issuers,
Owners, Management Agents

Handbook No: 2000.04 REV-2 CHG-1
Issued: **December 31, 2001**

1. This Transmits Handbook 2000.04 REV-2 CHG-1, Consolidated Audit Guide for Audits of HUD Programs.
2. Summary. This handbook is a change to Handbook IG 2000.04 REV-2 dated August 25, 1997. A change was necessary to reflect changes in financial reporting standards for HUD Housing programs. This Handbook serves as a reference to independent auditors of selected Housing and Ginnie Mae programs.
3. Significant Changes
 - a. Incorporates revised reporting standards and program compliance for Multifamily Housing.
 - b. Clarifies reporting requirements for Title II Nonsupervised Loan Correspondents.

Distribution: W-3-1, W-1, W-2, W-3. W-4, R-1, R-2, R-3, R-3-1, R-6, R-6-1, R-6-2, R-7, R-7-1, R-7-2, R-8

Handbook 2000.04 REV-2 CHG-1

U.S. Department of Housing and Urban Development
Office of Inspector General

Independent Auditors

December 2001

Consolidated Audit Guide for Audits of HUD Programs

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<u>Paragraph</u>		<u>Page</u>
Table of Contents		
1.	GENERAL AUDIT GUIDANCE	1-1
2.	REPORTING REQUIREMENTS AND SAMPLE REPORTS	2-1
3.	[RESERVED]	3-1
4.	HUD MULTIFAMILY HOUSING PROGRAMS	4-1
5.	INSURED DEVELOPMENT COST CERTIFICATION AUDIT GUIDANCE .	5-1
6.	GINNIE MAE ISSUERS OF MORTGAGED-BACKED SECURITIES AUDIT GUIDANCE	6-1
7.	HUD-APPROVED TITLE II NONSUPERVISED MORTGAGEES AND LOAN CORRESPONDENTS AUDIT GUIDANCE	7-1
8.	HUD-APPROVED TITLE I NONSUPERVISED LENDERS AND LOAN CORRESPONDENTS AUDIT GUIDANCE	8-1

CHAPTER 1. GENERAL AUDIT GUIDANCE

- 1-1 Purpose. This guide is to assist independent auditors (IAs) in performing program-specific audits of participants in selected Department of Housing and Urban Development (HUD) Housing and Ginnie Mae programs. These audits must be performed in accordance with the standards for financial audits of the U.S. General Accounting Office's (GAO) Government Auditing Standards, issued by the Comptroller General of the United States. The objectives of a HUD program-specific audit are to assist the program managers in HUD in determining whether the auditee has: (a) provided financial data and reports that can be relied upon; (b) internal control in place to provide reasonable assurance that it is managing HUD programs in compliance with applicable laws and regulations; and (c) complied with the terms and conditions of Federal awards and guarantees, and thus expended Federal funds properly and with supporting documentation. This guide is effective for audits of fiscal years ending March 31, 2002 and thereafter.

HUD program audit reports are a primary tool used by program managers to meet their stewardship responsibilities in overseeing these HUD programs and assuring the integrity of the funds. Program managers must act upon the areas of noncompliance and internal control weaknesses noted in these reports. To be of value, these reports must contain adequate information to give reported matters perspective and to allow the managers to take necessary corrective action.

Use of this guide is mandatory for audits by IAs of all for profit HUD program participants. Audits of non-profit participants are to be conducted in accordance with OME Circular A-133 and related guidance.

This guide is divided into chapters. The first chapter discusses purpose, background, audit planning and other considerations and establishes certain requirements for the performance of the audit. The second chapter contains the reporting requirements. The remaining chapters of the guide contain a compliance supplement for a particular HUD program (Chapter 3 has been reserved for future use). Each audit

should be conducted in accordance with requirements of Chapters 1 and 2 and the applicable compliance supplement included in Chapters 4 through 8 of this guide.

Chapter 4 of this guide is reproduced in its entirety in the Real Estate Assessment Center's (REAC) *Summary of Financial Reporting and Audit Guidance for Multifamily Program Participants and Independent Auditors*. This summary is available on HUD's website at <http://www.hud.gov/reac/products/prodmf.html>. Auditors should refer to that document for a detailed discussion on HUD's electronic submission reporting requirements for multifamily program participants (refer to 24 CFR Par 5, Subpart H).

This guide is not intended to be a complete manual of procedures, nor is it intended to supplant the auditor's judgment of audit work required. Suggested audit procedures contained herein may not cover all circumstances or conditions encountered in a particular audit. The auditor should use professional judgment to tailor the procedures so that the audit objectives may be achieved. However, all applicable compliance requirements in this guide must be addressed by the auditor. If the auditor desires technical assistance pertaining to HUD programs, their regulations or operations, the auditor should contact the particular HUD Headquarters or Field program office listed in the applicable chapter. A list of local and state offices is available on the Internet at <http://www.hud.gov>.

- 1-2 Auditor Qualifications. An auditor must meet the auditor qualifications of Government Auditing Standards, including the qualifications relating to independence and continuing professional education. Additionally, the audit organization is to meet the quality control standards of Government Auditing Standards. While the Government Auditing Standards urge audit organizations to make their external quality control review reports available to appropriate oversight bodies, it is not necessary to submit the report to either the HUD Field office or the HUD/OIG unless requested to do so.

The standards on auditor qualifications in the Government Auditing Standards require that accountants and accounting firms comply with the applicable provisions of the public

accountancy laws and rules of the jurisdictions in which they are licensed and where the audit is being conducted. If the auditee is located in a State outside the home State of the auditor, and the auditor performs substantial fieldwork in the auditee's State, the auditor should document his/her compliance with public accountancy laws of that State regarding licensing, in the audit working papers. This guide does not impose additional licensing requirements beyond those established by the individual state board of accountancies (some states allow temporary practice without a license).

Refer to HUD Handbooks 4370.2 and 4470.1 regarding additional requirements placed on the IA's relationship with the mortgagor and/or general contractor.

- 1-3 Audit Scope and Approach. The audit should be sufficiently comprehensive in scope to permit an expression of an opinion on the financial statements and supplemental data of the HUD-assisted activity.

The opinion should state whether the basic financial statements present fairly, in all material respects, the financial position of the auditee as of the date of the financial statements and the results of its operations and its cash flows for the period then ended in conformity with accounting principles generally accepted in the United States of America. In addition, the opinion should state that the supplemental data has been subjected to the audit procedures applied in the audit of the basic financial statements and whether it is fairly stated in all material respects in relation to the financial statements taken as a whole.

The Government Auditing Standards require the IA to consider the auditee's internal control as part of planning and performing the audit and report on internal control. The auditor should report on internal control in accordance with Chapter 2 of the guide.

Also, the IA is required to test and report on the auditee's compliance with applicable HUD laws and regulations regardless of the amount of Federal financial assistance. The auditor's report on compliance should include an opinion on the auditee's compliance with specific requirements

applicable to each of its major programs. Reporting requirements are discussed further in Chapter 2. Major program means an individual assistance program or a group of programs in a category of Federal financial assistance, which exceeds \$300,000 during the applicable year. A project, which has an outstanding HUD-insured or guaranteed loan balance exceeding \$300,000 as of the reporting date, shall be considered a major program. A mortgagee or loan correspondent, which originates and/or services an aggregate of FHA-insured loans exceeding \$300,000 during the period under audit, is considered a major program. In addition, a Government National Mortgage Association (Ginnie Mae) Issuer with a remaining principal balance exceeding \$300,000 as of the reporting date is considered a major program.

For Projects/Lenders/Issuers with HUD-assisted activity of \$300,000 or less for the period under audit (a non-major program), the auditor must also test and report on the entity's compliance with specific requirements. The auditor's report on compliance is described in Chapter 2.

Government Auditing Standards require the reporting of all material instances of noncompliance and quantification in terms of dollar value, if appropriate.

- 1-4 Matters Requiring Immediate Attention. The auditor should specifically assess the risk of material misstatement of the financial statements due to fraud and should consider that assessment in designing the audit procedures to be performed. In making this assessment, the auditor should consider fraud risk factors contained in AICPA SAS No. 82, Consideration of Fraud in a Financial Statement Audit.

Normally, an audit in accordance with generally accepted auditing standards does not include audit procedures specifically designed to detect illegal acts. However, procedures applied for the purpose of forming an opinion on the financial statements may bring possible illegal acts to the auditor's attention.

If the auditor becomes aware of illegal acts or fraud that have occurred or are likely to have occurred, the auditor should promptly prepare a separate written report and include all questioned costs. The auditor should submit this report to the HUD District Inspector General for Audit

(DIGA), as the designated oversight official. A current list of DIGAs is available on the Internet at <http://www.hud.gov/oig/oigindex.html> and in the Appendix.

- 1-5 Planning the Audit. A letter of engagement between the auditee and the IA shall be prepared. The letter should state that the audit is to be performed in accordance with generally accepted auditing standards, the Government Auditing Standards, and this audit guide. It should specify that the scope of the audit and the contents of the financial report meet the requirements of this audit guide. It should also specify that the auditor is required to provide the Secretary of Housing and Urban Development, the HUD Inspector General and the GAO or their representatives access to working papers or other documents to review the audit. Access to working papers by HUD and GAO representatives includes making necessary photocopies.

Generally, the auditor should use professional judgment to determine the extent of testing necessary to support his/her opinion on the auditee's financial statements and to report on the auditee's compliance with applicable laws and regulations. Each of the applicable compliance requirements contained in this guide must be tested regardless of the amount of Federal financial assistance. Where the auditor decides not to perform detailed testing of a particular compliance requirement, the reasons therefore must be appropriately explained and documented in the working papers.

All material instances of noncompliance identified by the auditor must be reported as a finding, even in those cases where corrective action was taken by the auditee after the audit period. For guidance, consult the particular program chapter. The schedule of findings and questioned costs (Chapter 2, Example F) must include the following information for each finding, where applicable, as required by the Government Auditing Standards: (a) the number of items and dollar value of the population; (b) the number of items and the dollar value of the selected sample; and (c) the number of items and the dollar value of the instances of noncompliance.

The auditor is required to obtain written representation from management that includes matters concerning compliance

with program laws and regulations that have a material effect on the financial statements and each HUD-assisted program.

The auditor shall retain working papers and reports for a minimum of three years from the date of the audit report, unless the auditor is notified in writing by a HUD office or the GAO to extend the retention period. When auditors are aware that HUD or the auditee is contesting an audit finding, the auditor shall contact the parties contesting the audit finding for guidance prior to destruction of the working papers and report.

- 1-6 Consideration of Internal Control Compliance. Overall guidance for the consideration of internal control, testing and reporting requirements for Federal financial assistance programs is provided in the Government Auditing Standards.

The Government Auditing Standards require that a sufficient understanding of internal control be obtained to plan the audit and to determine the nature, timing, and extent of tests to be performed. In fulfilling the audit requirement relating to an understanding of internal control and assessing the level of control risk, the auditor should follow, at a minimum, the guidance contained in AICPA SAS No. 55, Consideration of the Internal Control in a Financial Statement Audit and SAS No. 78, Consideration of Internal Control in a Financial Statement Audit: An Amendment to SAS No. 55. In addition, when auditing HUD programs, the auditor should perform tests of controls to evaluate the effectiveness of the design and operation of internal control in preventing or detecting material noncompliance with the requirements of the HUD-assisted programs. The auditor should perform these procedures regardless of whether the auditor assesses the internal control risk below the maximum. The steps performed and conclusions reached should be clearly evidenced in the auditor's working papers. The working papers should clearly demonstrate the auditor's understanding and assessment of control risk related to internal control established for HUD-assisted activities. Tests may be omitted only in areas when internal control is likely to be ineffective in preventing or detecting noncompliance, in which case a reportable condition or material weakness should be reported.

- 1-7 Quality Control Review for Audit Reports. The HUD Office of Inspector General (OIG) and the REAC have implemented procedures for evaluating audits performed by non-Federal auditors. As part of this evaluation of completed audits, the supporting audit working papers shall be made available upon request by the OIG or the REAC. To facilitate these requests, the transmittal letter should include the name, firm address, and telephone number of the audit partner on the engagement and the IA's Federal employer ID number.

Whenever an evaluation of an audit report or working papers discloses inadequacies, the IA may be asked to take corrective action. If HUD determines that the audit report and working papers are substandard or contain major inadequacies, it will consider filing complaints with the cognizant State Board of Accountancy and initiating action to debar the practitioner from further participation in Federal programs.

- 1-8 Corrective Action Plan. To assist the Department in resolving instances of noncompliance and material weaknesses in internal control identified by the auditor, the auditee is required to submit a corrective action plan with the auditor's report on HUD-assisted programs. In the corrective action plan, the auditee must describe the corrective action taken or planned in response to findings identified by the auditor. In addition, the auditee must comment on the status of corrective action taken on prior findings. The corrective action plan is considered a necessary part of the Project/Lender/Issuer's audit requirement. Additional guidance concerning the corrective action plan is contained in Chapter 2 of this guide.

- 1-9 Fair Housing and Non-Discrimination. When performing compliance work in the fair housing and non-discrimination area, the following references should be used: HUD Handbook 8004.1, Consolidated Civil Rights Monitoring Requirements for Section 8; 24 CFR Part 1 (Title VI of the Civil Rights Act, Americans with Disabilities Act, and others) and Part 8 (Section 504 of the Rehabilitation Act)(both of which are applicable to all HUD-assisted housing); and 24 CFR Part 100, The Fair Housing Act (applicable to all housing in the nation). The Fair Housing Act prohibits discrimination based on race, color, religion, national origin, sex, familial status or disability in all aspects of the

2000.04 REV-2 CHG-1

of the sale or rental of a dwelling (familial status refers to family composition, such as number and ages of children). The prohibitions extend to actions, which have disparate impact because of any of the prohibited bases.

CHAPTER 2. REPORTING REQUIREMENTS AND SAMPLE REPORTS

2-1 Government Auditing Standards require that the auditor issue the following reports based on the audit of the financial statements: a report on the financial statements, a report on compliance with applicable laws and regulations, and a report on internal control. In addition, there are additional reports required to be issued in an audit conducted in accordance with this audit guide. The audit report should be issued to the auditee's governing body and/or top official, as appropriate. The report cover should clearly indicate the HUD-assisted activities and period(s) that were audited.

It is expected that the specific compliance requirements identified in this guide will cover those laws and regulations that, if not complied with, could have a direct and material effect on the financial statements. In such cases, the compliance reports (in Section C below) and illustrated in this guide are the only reports necessary for reporting on the auditee's compliance with laws and regulations. However, if the IA, as part of the audit of the financial statements, considered laws and regulations in addition to those noted in this guide, for which noncompliance could have a direct and material effect on the financial statements, the auditor should also issue the compliance report in accordance with Government Auditing Standards.

The following reports are required to be submitted by the auditee:

- A. The auditor's report on the basic financial statements together with the auditor's report on accompanying supplemental information required by HUD, stating whether that supplemental information is fairly stated in all material respects in relation to the basic - financial statements taken as a whole (Example A).
- B. The auditor's combined report on internal control as it relates to both financial reporting and administering the HUD-assisted programs. It must identify any reportable conditions and material weaknesses noted (Example B).
- C. A report on compliance with applicable laws and regulations that may have a direct and material effect on each HUD-assisted program including:

- an opinion on compliance with specific requirements applicable to major HUD-assisted programs (Example C)
- a report on compliance with specific requirements applicable to non-major HUD-assisted programs (Example D)

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 non-major, 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.

The report on compliance should also identify and include all material instances of noncompliance. The findings should include an identification of all material questioned costs, as a result of noncompliance. In addition, the findings should contain adequate information necessary to facilitate the audit resolution process, i.e. the number of items and dollar value of the population, the number of items and the dollar value of the selected sample, and the number of items and the dollar value of the instances of noncompliance (Example F). Nonmaterial instances of noncompliance should be communicated to the auditee in accordance with the Government Auditing Standards.

- D. In the auditee's comments on audit resolution matters, the auditee should determine if significant findings from previous HUD required annual audits, HUD-OIG audits, HUD management reviews, or REAC physical inspections have been corrected and disclose those which remain uncorrected at the time of the review (Example G). The auditor is required to follow up on prior audit findings, perform procedures to assess the reasonableness of the comments on audit resolution matters relating to HUD programs prepared by the auditee, and report, as a current-year audit finding, when the auditor concludes that the comments materially misrepresent the status of any prior audit finding(s).

- E. Any report from the auditors on illegal acts or fraud that have occurred or are likely to have occurred, including all questioned costs found as a result of these acts that the auditors become aware of, should be covered in a separate written report in accordance with the provisions of the Government Auditing Standards. This report should be sent to the cognizant District Inspector General for Audit (see Appendix for list of District Inspectors General for Audit). Illegal acts are to be reported on without regard to whether the condition giving rise to the questioned costs has been corrected or whether the auditee does or does not agree with the finding and questioned costs.
- F. A corrective action plan developed by the auditee, wherein the auditee officials describe the corrective action taken or planned in response to the findings identified by the auditor. The plan should also include comments on the corrective action taken on prior findings resulting from IA or relevant HUD-OIG audits and HUD program reviews (Example H).

2-2 Auditor's Reports. The following are illustrations of reports on financial statements, on internal control, on compliance with specific requirements and the auditee's corrective action plan that may be issued in an audit in accordance with this guide. These reports are not meant to be all-inclusive; auditors should exercise professional judgment in tailoring their reports to the circumstances of individual audits.

Examples:

- A. Report on Audited Financial Statements and Supplemental Information.
- B. Report on Internal Control.
- C. Opinion on Compliance with Specific Requirements Applicable to Major HUD Programs.
- D. Report on Compliance with Specific Requirements Applicable to Non-major HUD Program Transactions.
- E. Report on Compliance with Specific Requirements Applicable to Fair Housing and Non-Discrimination.
- F. Schedule of Findings and Questioned Costs.

2000.04 REV-2 CHG-1

- G. Auditee's Comments on Audit Resolution Matters Relating to HUD Programs.
- H. Corrective Action Plan (An Auditee Responsibility).

EXAMPLE A

REPORT ON AUDITED FINANCIAL STATEMENTS AND SUPPLEMENTAL
INFORMATION

Independent Auditor's Report

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

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

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of [the Entity] as of December 31, 20XX, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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

2000.04 REV-2 CHG-1

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

CPA and Company
Certified Public Accountants

Anytown, U.S.A.
[Date]

EXAMPLE B

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL (COMBINED REPORT APPLICABLE TO INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS AND INTERNAL CONTROL OVER COMPLIANCE FOR HUD-ASSISTED PROGRAMS--REPORTABLE CONDITIONS WERE NOTED--NO MATERIAL WEAKNESSES)

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

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

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

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

We noted certain matters involving internal control and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect [the Entity's] ability to record, process, summarize, and report

financial data consistent with the assertions of management in the financial statements or its ability to administer HUD-assisted programs in accordance with applicable laws and regulations.

[Include paragraphs to describe the reportable conditions noted.]

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

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

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

CPA and Company
Certified Public Accountants

Anytown, U.S.A.
[Date]

EXAMPLE C

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

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

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

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

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

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

CPA and Company
Certified Public Accountants

2000.04 REV-2 CHG-1

Anytown, U.S.A.

[Date]

EXAMPLE D

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

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

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

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

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

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

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

CPA and Company
Certified Public Accountants

Anytown, U.S.A.
[Date]

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

To the Partners
[the Entity]
Anytown, USA

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

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

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

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

CPA and Company
Certified Public Accountants

Anytown, U.S.A.
[Date]

12/01

2-12

EXAMPLE F

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

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

When the auditor identifies a finding, this schedule must include the following information for each finding, where applicable: (a) the size and corresponding dollar value of the population, (b) the size and dollar value of the sample tested, and (c) the size and dollar value of the instances of noncompliance.

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

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

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

2000.04 REV-2 CHG-1

describing the reason it is not should accompany the audit report.

12/01

2-14

EXAMPLE G

AUDITEE'S COMMENTS ON AUDIT RESOLUTION MATTERS RELATING TO HUD PROGRAMS

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

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

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

Finding No. 2 -

Status -

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

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

CORRECTIVE ACTION PLAN

Name and Number of Project _____

Auditor/Audit Firm _____

Audit Period _____

The following is a recommended format to be followed by auditees for submitting a corrective action plan:

Section I - Internal Control Review

A. Comments on Findings and Recommendations

The auditee should provide a statement of concurrence or nonconcurrence with the findings and recommendations. If the auditee does not agree with a finding, specific information should be provided by the auditee to support its position. If the information is voluminous, an appendix may be attached to the submission.

B. Actions Taken or Planned

The auditee should detail actions taken or planned to correct deficiencies identified in the report. Appropriate documentation should be submitted for actions taken. For planned actions, auditees should provide projected dates for completion of major tasks. Officials responsible for completing the proposed actions should also be identified. If the auditee believes a corrective action is not required, a statement describing the reasons should be included.

C. Status of Corrective Actions on Prior Findings

The auditee must comment on all prior findings whether or not corrective action has been completed. The auditee should provide a report on the status of corrective actions taken on prior findings that remain open. An update should be included on dates for completion of major tasks and responsible officials for any actions not completed. In addition, documentation should be submitted for any actions the auditee considers completed.

Section II - Compliance Review

A. Comments on Findings and Recommendations

(See Section I. A. above.)

B. Actions Taken or Planned

(See Section I. B.)

C. Status of Corrective Actions on Prior Findings

(See Section I. C.)

CHAPTER 3. [RESERVED]

CHAPTER 4. HUD Multifamily Housing Programs

- 4-1 Background. This chapter contains HUD's requirements for conducting annual financial audits of entities participating in profit motivated and limited distribution multifamily housing programs.

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

- 4-2 Reporting Requirements. The Regulatory Agreement incident to the insured mortgage requires the annual submission of audited financial statements prepared in accordance with the requirements of the Secretary, within 90 days after the end of the fiscal year. In addition to the basic financial statements of the housing project, the auditor is required to submit a report on the consideration of internal controls and a report on compliance with specific requirements as well as supplemental data reports. These statements must be certified to be accurate by the mortgagor, when the project is owned by an individual. It should be certified by two general partners, when the project is owned by a partnership or by two officers, when owned by a corporation. When circumstances prohibit the ideal number of partners, or officers' certifying signatures, explanatory information should be provided with the audit report. These statements must also be certified to by the CEO of the management agent, where applicable. The report shall include the Employer Identification Number assigned by the IRS. This number must be entered below the partner or corporate signatures. The report should include the following basic financial statements plus supplemental data prepared in accordance with REAC instructions.

The auditors, role is to conduct and report the results of their audit in accordance with generally accepted auditing standards (GAAS) and generally accepted government auditing standards (GAGAS). It is the owner's responsibility to file an accurate electronic submission with HUD's Real Estate Assessment Center. In that regard, the Independent Auditor shall:

- A. Issue an *Independent Auditors' Report* (refer to Chapter 2, Example A) on the ownership entity's basic financial statements. This report should cover the following items:

- o Balance Sheet
 - o Statement of Income
 - o Statement of Changes in Partner's Capital 1/
 - o Statement of Cash Flows
 - o Footnotes to the basic financial statements, including descriptions of accounting policies.
- B. Issue an *Independent Auditors' Report* (refer to Chapter 2, Example A) on the supplemental information. This report may be added to the auditors' report on the basic financial statements or may appear separately in the auditor-submitted document 2/.
- C. Issue the additional reports described in Chapter 2.

4-3 Compliance Requirements and Audit Areas

A. Federal Financial Reports

1. Compliance Requirement. Projects participating in HUD-assisted activities are required to ensure that financial status reports contain reliable financial data and are presented in accordance with the terms of applicable agreements between the entity and HUD. The individual agreements contain the specific reporting requirements that the entity is to follow.
2. Suggested Procedures
 - a. Identify all required financial reports by inquiry of the owner/manager.
 - b. Obtain an understanding of the auditee's procedures for preparing and reviewing the financial reports.

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

2/ Refer to AICPA Professional Standards, Volume 1, U.S. Auditing Standards, AU §551.06 e.

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

B. Fair Housing and Non-Discrimination

- 1. Compliance Requirement. Management and owners are prohibited from discriminatory practices in accepting applications, renting units and designating units or sections of a project for renting to prohibited bases of the "Fair Housing Act" and according to the Regulatory Agreement.
- 2. Suggested Audit Procedures
 - a. Obtain a copy of the owner's approved Affirmative Fair Housing Marketing Plan, if applicable to the project.
 - b. Inquire of the owner/manager as to policies and procedures relating to: marketing of the units; processing, approving and rejecting applications, including determining that applicants are processed and selected in appropriate order; and providing reasonable

accommodation to applicants and tenants with disabilities in accordance with the requirements of applicable federal civil rights laws.

- c. Test whether procedures were placed in operation as established by management through inquiry and examination of documentary evidence.
- d. Review a sample of correspondence files for applications rejected, including documented reasons for valid rejections, or tenants evicted and legal invoices for any evidence of litigation or potential litigation related to discriminatory rental practices.
- e. Determine that the HUD-approved Equal Housing Opportunity logo, slogan or statement is displayed in marketing materials.

C. Mortgage Status

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

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

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

D. Replacement Reserve

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

- e. Trace disbursements from the reserve for replacement to the associated HUD approval form and canceled invoices. Trace to the client's general ledger, monthly (or annual) mortgage statements) and the schedule prepared above. Determine if sampled disbursements were authorized by HUD and used for the purpose authorized by HUD.
- f. Confirm the account balance and annual reserve for replacement account activity with the loan servicer as of the client's fiscal year end. (Note: the auditor should use alternative procedures to satisfy this requirement if the auditor considers the confirmation process unreliable or impractical.)

E. Residual Receipts

- 1. Compliance Requirement. Owners of limited distribution properties shall establish a residual receipts account and make deposits into the account in accordance with HUD requirements. Disbursements from such fund may be made only after receiving written consent from HUD (source - HUD Regulatory Agreement).
- 2. Suggested Audit Procedures
 - a. Read the client's Regulatory Agreement (and any amendments) to determine the client's requirements for making deposits into the residual receipts fund. Normally, program participants are required to deposit "surplus cash" into the account within 60 days after the end of each fiscal year.
 - b. Determine that the prior year's amount required to be deposited to the residual receipts fund was calculated correctly and deposited within 60 days of the close of the fiscal year.
 - c. Using the schedule prepared for the mortgage status compliance requirement, verify the residual receipts account activity for the reporting period for compliance with the client's Regulatory Agreement.

- d. Verify that deposits were made into the residual receipts account.
- e. Trace disbursements from the residual receipts account to the associated HUD approval form and canceled invoices. Trace to the client's general ledger, monthly (or annual) mortgage statements) and the schedule prepared above. Determine if disbursements were authorized by HUD and used for the purpose intended.
- f. Confirm the account balance and annual residual receipts account activity with the loan servicer as of the client's fiscal year end. (Note: the auditor should use alternative procedures to satisfy this requirement if the auditor considers the confirmation process unreliable or impractical.
- g. Test whether established procedures for deposit of cash receipts into a federally insured bank are being followed through inquiry and examination of documentary evidence.

F. Distributions to Owners

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

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

G. Tenant Application, Eligibility, and Recertification

1. Compliance Requirement. Owners who participate in HUD's rent subsidy programs are responsible for accepting applications, correctly calculating the tenant's contribution toward rent and utilities and correctly calculating any subsidy. They are also responsible for determining initial tenant eligibility, annual recertification of tenant eligibility, and rectifying improper or inaccurate tenant information.
2. Suggested Audit Procedures
 - a. Compare the client's procedures for accepting applications, determining initial eligibility, total tenant payment, and reexamination of eligibility with the provisions in HUD Handbook 4350.3.

12/01

4-8

- b. Review a sample of tenant files to determine that applications are complete, signed by the applicant, that tenants met the eligibility requirements pertaining to their subsidized unit for annual income, and family composition, that the tenant payment was calculated correctly and that the family income was reexamined on an annual basis. Include in the sample some of the oldest and some of the most recently admitted tenants.
- c. Review a sample of tenant files for evidence of whether the owner noted any improper or inaccurate information while determining tenant eligibility or during tenant recertification. If so, determine that the owner followed the guidance in HUD Handbook 4350.3 pertaining to overpayment of a subsidy and follow-up to suspected fraud.
- d. Review a sample of tenant files to determine that the tenant file contains the following documents as follows:
 - (1) Application
 - (2) Required verifications of social security numbers, disability status, waiting list preferences, income and allowances for adjusted income
 - (3) Lease/Lease addenda in the form as required by HUD
 - (4) Certification and recertification forms (Form HUD-50059)
 - (5) Move-In and Move-Out inspections
 - (6) Computation of tenant's contribution toward rent and utilities and the subsidized portion of the tenant's monthly rent
- e. Test Section 8 rents to ensure that those rents do not exceed the fair market rents.
- f. Compare the amount claimed per the HAP billing

to the supporting documentation in the tenant files.

- g. Verify the mathematical accuracy of the billing, including the accuracy of the total number of units on the bill.

H. Management Functions

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

12/01

4-10

Conduct follow-up or corroboration of management's responses as considered necessary.

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

I. Unauthorized Change of Ownership/Acquisition of Liabilities

1. Compliance Requirements. Owners of profit, motivated and limited distribution properties shall not, without the prior written consent of HUD, convey, transfer, or encumber any of the mortgaged property, or permit the conveyance, transfer of encumbrance of such property (Source - HUD Regulatory Agreement).
2. Suggested Audit Procedures
 - a. Inquire of management about the existence of any agreements to sell or encumber any of the mortgaged property and read any agreements.
 - b. Confirm all material debt agreements listed on the client's balance sheet. Review confirmations to determine if a change of ownership has occurred, or if any of the mortgaged property was encumbered without HUD approval.
 - c. Review the results of the audit procedures applied to specific accounts or other general procedures to identify the existence of any unauthorized conveyance, transfer, or encumbrance of any of the mortgaged property.
 - d. Read the minutes of Partner meetings held during the reporting period for evidence of any unauthorized conveyance, transfer, or encumbrance of any of the mortgaged property.

J. Unauthorized Loans of Project Funds

1. Compliance Requirements. Owners of profit motivated and limited distribution properties shall not, without the prior written consent of HUD, assign, transfer, dispose of, or encumber any personal property of the project, including rents, or pay out any funds except from surplus cash, except for reasonable operating expenses and necessary repairs (Source - HUD Regulatory Agreement).
2. Suggested Audit Procedures
 - a. Inquire of management about the existence of any

agreements to assign, transfer, dispose of, or encumber any of the personal property of the project, including rents and read any agreements.

- b. Review the results of the audit procedures applied to specific accounts or other general procedures to identify the existence of any unauthorized transactions.
- c. Read the minutes of Partner meetings held during the reporting period. Highlight discussions of any unauthorized agreements to assign, transfer, dispose of, or encumber any of the personal property of the project.

K. Unauthorized Transfer of Beneficial Interest

- 1. Compliance Requirements. Owners of profit motivated and limited distribution properties shall not, without the prior written consent of HUD, convey, assign, or transfer any beneficial interest in any trust holding title to the property, or the interest of any general partner in a partnership owning the property, or any right to manage or receive the rents and profits from the mortgaged property (Source - HUD Regulatory Agreement).
- 2. Suggested Audit Procedures
 - a. Inquire of management about the existence of any agreements to convey, assign, or transfer any beneficial interest. 3/
 - b. Review the results of the audit procedures applied to specific accounts or other general procedures to identify the existence of any unauthorized conveyance, assignment, or transfer of any beneficial interest of any of the owners.
 - c. Read the minutes of Partner meetings held during the reporting period for evidence of discussions of any unauthorized conveyance, assignment or transfer of any beneficial interest of any of the owners.

3/ Beneficial interest is generally the right to profits from an estate or property, without owning the estate or property.

L. Electronic Submission Verification

1. Compliance Requirements. Owners of profit motivated and limited distribution properties are required to submit electronically to HUD audited financial information in accordance with GAAP and HUD requirements (Source - HUD Regulatory Agreement and 24 CFR Part 5, Subpart H)

2. Suggested Audit Procedures

Compare the client's FASS submission from the last reporting period to the Annual Financial Report prepared for the same period. Identify any material misstatements or omission from the data electronically submitted to HUD's REAC.

M. Excess Income

1. Compliance Requirements. Owners of limited distribution properties with mortgages insured under Section 236 of the National Housing Act must obtain prior authorization from HUD before retaining Excess Income and use Excess Income only for HUD authorized purposes.

2. Suggested Audit Procedures

a. Inquire of management about the existence of a letter of permission or denial from HUD with respect to Excess Income. If the owner has received a letter from HUD permitting or denying the retention of Excess Income, obtain and read a copy of that correspondence from the property's management.

b. Select a sample of the HUD forms HUD-93104, *Monthly Report of Excess Income* filed by the client, covering the period under audit. Determine if the reports selected were prepared in accordance with HUD instructions.

c. For the sample, determine if the client retained Excess Income or remitted the amount collected to HUD in accordance with HUD instructions. Trace amounts retained back to the client's supporting records.

12/01

4-14

- d. If Excess Income was retained by the client, determine if:
 - o HUD approved if the amount retained
 - o The amount retained was used for authorized purposes as enumerated in Housing Notices