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## 100 Introduction

100.1 The U.S. Department of Housing and Urban Development (HUD) sponsors a broad range of programs designed to revitalize urban neighborhoods, stimulate housing construction, encourage home ownership opportunities, and provide decent, safe, and affordable housing. The programs are primarily directed toward low and moderate income families. They are carried out through various forms of federal financial assistance, including entitlements, grants, direct loans and advances, subsidies, risk-sharing programs, and mortgage insurance. Depending on the particular program, recipients of the federal aid may be units of local government, such as states, cities, or counties; public housing authorities that develop, own, or operate housing projects; other profit motivated or nonprofit builders, developers, or owners of housing projects; mortgage lenders; or individuals. Examples of HUD program categories are Community Development Block Grants and single, multifamily, public, and Indian housing programs.

100.2 *PPC's Guide to HUD Audits* focuses on HUD-assisted multifamily housing projects owned by business entities (for-profit entities) and nonprofit entities. The *Guide's* objective is to assist auditors of HUD-assisted multifamily housing projects in auditing the financial statements in accordance with both generally accepted auditing standards and generally accepted government auditing standards and reporting on the entity's compliance with laws and regulations affecting HUD-assisted programs. The *Guide* also provides guidance about the accounting and financial statement presentation issues that are common for HUD-assisted projects.

100.3 *PPC's Guide to HUD Audits* provides limited guidance for auditors of nonsupervised and supervised lenders that participate in FHA insurance programs in Chapter 9. This *Guide* also provides limited guidance to auditors about the Low-Income Housing Tax Credit (LIHTC). The LIHTC is a federal income tax credit administered by the states that was established to encourage and finance new construction and rehabilitation of existing housing for low-income households. Chapter 10 of this *Guide* provides an overview of the LIHTC regulations, explains the services that auditors may provide for these projects, discusses compliance issues related to ongoing and initial project completion, and illustrates independent accountants' reports for LIHTC projects.

100.4 The remainder of this introductory chapter provides an overview of the following topics:

- a. HUD's multifamily housing programs.
- b. HUD offices that are important to auditors.

c. Participants in HUD's programs.

d. Audit and accounting guidance applicable to owners of multifamily housing projects that receive assistance from HUD.

e. Accountants' involvement with HUD clients.

f. The PPC risk assessment process.

g. Organization and scope of *PPC's Guide to HUD Audits*.

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## 101 Types of Multifamily Housing Programs

101.1 Most of HUD's multifamily housing programs can be classified into the following broad categories:

- a. Multifamily mortgage insurance.
- b. Coinsured loans.
- c. Risk-sharing programs.
- d. Direct loans, capital advances, flexible subsidies, and grants.
- e. Rental subsidies.

HUD programs are established by housing legislation. Thus, many HUD programs are identified by a number that refers to legislation under which the program was enacted. For example, the legal authority for Section 8 rental subsidy programs is Section 8 of the U.S. Housing Act of 1937. HUD programs are implemented through regulations, which are found at Title 24 of the *Code of Federal Regulations*.

101.2 From an auditor's perspective, knowing what type of HUD program each multifamily housing project operates under is important because accounting considerations and specific auditing and compliance procedures can vary by program type. The discussion beginning at paragraph 101.3 provides an overview of the principal types of multifamily housing programs. Chapter 2 describes the specific programs within each category in greater detail.

### Insured Loans

101.3 HUD administers several mortgage insurance programs that provide insurance to lenders to encourage them to make loans to developers and builders who construct or rehabilitate multifamily housing projects.

Depending on the particular program, loan proceeds may be used to finance the construction of new housing or acquire or rehabilitate existing housing. Under the programs, HUD insures lenders against loss on a mortgage if a borrower (project owner) defaults during the life of the mortgage loan. If the borrower defaults, the lender can assign the mortgage to HUD, making HUD responsible for servicing. HUD can also take legal action to take possession of the property and become the owner.

101.4 The principal HUD multifamily mortgage and loan insurance programs are as follows:

- Section 207 Multifamily Rental Housing
  
- Section 207 Manufactured Home Parks
  
- Section 213 Cooperative Housing
  
- Section 220 Urban Renewal Projects
  
- Section 221 Multifamily Rental Housing for Low and Moderate Income Families
  
- Section 223(f) Purchase or Refinancing of Existing Projects
  
- Section 223(a)(7) Refinancing of Existing Projects
  
- Section 231 Housing for the Elderly and Handicapped
  
- Section 232 Nursing Homes, Assisted-Living Facilities, and Intermediate Care Facilities
  
- Section 234(d) Condominium Housing
  
- Section 236 Interest Reduction Program
  
- Section 241(a) Insured Supplemental Loans on Multifamily Housing Projects

- Section 242 Hospitals

As discussed in section 201, some insured loan programs are targeted for low and moderate income housing, while others are designed specifically for elderly or handicapped persons.

### **Coinsured Loans**

101.5 Housing legislation enacted in 1974 authorized HUD to coinsure mortgages with approved coinsuring lenders. The objective of the coinsurance programs was to facilitate the efficient processing of mortgage applications. Under the programs, the coinsuring lenders agreed to abide by HUD's requirements, to perform HUD's normal loan underwriting functions, and to share a portion of the risk of loss. Many project owners and coinsuring lenders were unable to honor their financial obligations, however, causing HUD to sustain large losses. As a result, HUD terminated its coinsurance programs in 1990.

101.6 Although coinsured mortgages are no longer made, HUD continues to service coinsured mortgages underwritten prior to November 12, 1990, and mortgages to protect owners whose applications were in process but had not been approved as of that date. Subsequently, multifamily housing mortgages are underwritten by HUD staff with limited use of "delegated processing" to private sector mortgage companies.

### **Risk-sharing Programs**

101.7 The multifamily risk-sharing program is designed to encourage the production of affordable rental housing by allowing HUD to provide risk-sharing arrangements to state and local housing finance agencies. Created under Section 542 of the Housing and Community Development Act of 1992 (also called the Multifamily Housing Finance Improvement Act), the insurance program was created to demonstrate the effectiveness of providing new forms of credit enhancement for multifamily loans. A housing finance agency must be approved by HUD to participate in this program. To be eligible, the agency must be a HUD-approved multifamily mortgagee in good standing and meet other credit, experience, and management criteria.

### **Direct Loans, Capital Advances, Flexible Subsidies, and Grants**

101.8 **Section 202 Direct Loans** Under Section 202 of the National Housing Act of 1959, HUD was authorized to make long-term loans directly to multifamily housing projects. Loan proceeds were used to finance the construction of housing for persons age 62 or older and handicapped persons. In 1990, amendments to Section 202 replaced the direct loan program with "capital advance" programs for owners of housing designed for elderly or disabled residents. (See paragraph 101.11.) HUD continues to service direct loans that were made under the old Section 202 program.

101.9 All projects that received Section 202 direct loans also are eligible for assistance under HUD's Section 8 rent subsidy program.

101.10 **Direct Loans under the Property Disposition Purchase Money Mortgage Program** In the 1970s, a direct loan program was established to facilitate sales of projects that HUD had previously acquired through foreclosure. Under the Property Disposition Purchase Money Mortgage Program, HUD would sell the property and take back a purchase money mortgage of up to 90% of the selling price. These projects were often provided with Section 8 rent subsidies. HUD no longer issues purchase money mortgages when selling properties in its inventory. It now sells such properties on a "cash only" basis.

**101.11 Capital Advance Programs** HUD makes capital advances to nonprofit organizations for the construction, acquisition, or rehabilitation of housing for persons age 62 or older (under Section 202 of the Housing Act of 1959 as amended) or disabled persons (under Section 811 of the National Affordable Housing Act). Capital advances bear no interest and need not be repaid so long as the housing remains available to elderly or disabled persons for at least 40 years. Only nonprofit projects are eligible for assistance under capital advance programs. Capital advance projects are typically supplemented with rental assistance. (See paragraph 101.14 and sections 204 and 205.)

101.12 The American Homeownership and Economic Opportunity Act of 2000 includes amendments to the section 202 and 811 programs intended to facilitate the rehabilitation and preservation of these properties. See discussion of the Section 202/811 Mixed-Finance Program in section 204.

**101.13 Flexible Subsidies** Two types of loans are available under HUD's flexible subsidy program—operating assistance loans and capital improvements loans. Both types of loans are generally made to projects with mortgages that are either insured or held by HUD. Operating assistance loans are made to projects that are experiencing operating deficits. They are designed to provide temporary funding to replenish project reserves, cover operating costs, and pay for limited physical improvements. Capital improvements loans are intended to assist projects with the cost of major repair and replacement of building components when project reserves are insufficient to fund the improvements.

### **Rental Subsidies**

101.14 HUD rent subsidy programs provide financial assistance to low-income tenants of multifamily housing projects through payments that reduce the rent they pay. Under the programs, eligible tenants are only required to pay a portion of the market or HUD-approved rent, and HUD pays the difference on behalf of the tenants to the project owners. Not all units within a HUD project need be rent subsidized; depending on a tenant's income level, some units may be leased at market rate.

101.15 The largest rent subsidy program is authorized under Section 8 of the U.S. Housing Act of 1937. The “Section 8 Program” includes eight principal subprograms targeted toward different types of housing projects and tenants with different income levels. Other rent subsidy programs are (a) rent supplements, (b) rental assistance payments, and (c) project rental assistance under the Section 202 and Section 811 capital advance programs. Rental subsidies often accompany insured, direct loan, or capital advance programs.

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## 102 The HUD Organization

### HUD Headquarters

102.1 The Department of Housing and Urban Development—HUD headquarters—in Washington, D.C., administers all HUD programs nationwide. Much of the activity at HUD headquarters relates to HUD's administrative and legislative functions and, thus, does not directly concern auditors. However, auditors may interact with certain departments when auditing HUD projects or for practice development purposes. The departments of primary interest to auditors are discussed in the following paragraphs.

102.2 **Office of the Inspector General (OIG)** The HUD OIG is responsible for promoting the integrity, efficiency and effectiveness of HUD programs. It works to accomplish this by conducting audits and investigating charges of fraud, waste, and abuse in HUD programs. OIG's other responsibilities include the following:

- a. Reviewing auditors' audit documentation to determine compliance with generally accepted auditing standards (GAAS) and generally accepted government auditing standards (GAGAS).<sup>1</sup> Auditors subject to review are selected from referrals received from other HUD offices. Firms with significant numbers of HUD clients are more likely to be reviewed by the OIG.
  
- b. Periodically updating HUD Handbook 2000.04, *Consolidated Audit Guide for Audits of HUD Programs* (the HUD audit guide)<sup>2</sup> to reflect changes in HUD regulations, GAAS, and GAGAS.

The HUD OIG can seek administrative sanctions, civil recoveries and/or criminal prosecution of those responsible for waste, fraud and abuse in HUD programs and operations. A current directory of HUD's OIG offices is available on the OIG's website at [www.hudoig.gov/about/where-were-located](http://www.hudoig.gov/about/where-were-located).

102.3 **Office of Financial Services** The Office of Financial Services maintains loan ledgers, escrow accounts, and reserve funds for mortgages of HUD projects that are held by HUD. (HUD may hold the mortgage because the borrower defaulted on a HUD-insured mortgage and the lender assigned the loan to HUD for insurance benefits or because it directly issued the mortgage.)

102.4 **Office of Housing Assistance and Grant Administration** The Office of Housing Assistance and Grant Administration administers the direct loan and capital advance programs for the elderly and disabled. As a

result, that office maintains information concerning projects whose owners are in the process of applying for assistance under those programs. On request, it will send auditors information on prospective HUD projects in their locality, which auditors may use for practice development purposes.

**102.5 Office of the Secretary** Within the Office of the Secretary, the office of greatest interest to auditors is the Mortgagee Review Board, which examines the conduct of mortgagees and loan correspondents who participate in HUD housing programs. Chapter 9 of this *Guide* discusses mortgagees.

**102.6 Office of Recapitalization** The Office of Recapitalization was created in 2014 to absorb the Office of Affordable Housing Preservation, the administrator of the Mark-to-Market program (M2M) after the legislative sunset of the Office of Multifamily Housing Assistance Restructuring (OMHAR). The M2M program was created to reduce the rents on expiring housing subsidy contracts to market levels and restructure existing debt to amounts that can be supported by these rents. In addition, the Office of Recapitalization oversees the Rental Assistance Demonstration Program (RAD) and the Section 236 Preservation Program. See section 200.

**102.7 Real Estate Assessment Center** HUD created its Real Estate Assessment Center (REAC) to centralize the assessment of all HUD housing. Its mission is to improve housing quality and assure the public trust by providing accurate, credible, and reliable assessments of HUD's real estate portfolio. It does this through physical inspections and financial assessments. REAC's financial assessment of multifamily housing programs is performed on the project's financial information electronically submitted through the FASSUB templates discussed at section 311. This centralized review ensures consistency of financial statement and supplementary information requirements among projects. In addition, REAC staff perform quality assurance reviews of auditor's workpapers. In these reviews, REAC staff visit auditor's offices across the country reviewing their audit documentation for conformance with professional standards, *Government Auditing Standards*, and HUD requirements. These reviews, discussed in more detail beginning at paragraph 401.85, are similar to the IG reviews described in paragraph 102.2.

**102.8 Enforcement Center** HUD also created the Enforcement Center to take action against HUD-assisted entities that are responsible for waste, fraud, and abuse in HUD programs. The center receives referrals from the REAC of entities failing their financial or physical inspections. The center seeks remedies from the entities and works with the OIG on criminal investigations.

## **HUD Field Offices**

**102.9** To administer HUD programs throughout the country, HUD has established state offices and area offices. The field offices have authority for the day-to-day oversight of HUD projects and for interpreting HUD requirements. Within each field office, the Asset Management Branch and the Mortgage Credit Branch are of particular importance. The Asset Management Branch controls releases from project reserve funds, conducts physical inspections of HUD projects, and reviews project accounting procedures and leasing practices. The Mortgage Credit Branch is responsible for reviewing "cost certifications" submitted by developers of HUD projects. (See paragraph 105.3.)

**102.10** There are currently approximately 80 field offices. A directory of HUD field offices is available on the Internet at [www.hud.gov/localoffices.cfm](http://www.hud.gov/localoffices.cfm).

**102.11** The field offices are organized into 10 geographic regions, each with a regional office. A "secretary's representative," assigned by the HUD secretary to each region, is responsible for ensuring that HUD policies developed in Washington are implemented throughout the country.

**102.12 Reorganization of HUD** HUD is currently in the process of implementing a plan to reorganize the

Office of Multifamily Housing by the end of 2016. The plan will consolidate the 50 HUD multifamily offices and seventeen regional hubs into five regions: Atlanta, Chicago, Fort Worth, New York, and San Francisco. Within each region there will be several asset management offices. The stated overarching goal of the plan is to cut FHA loan processing times; however, the plan is expected to result in cost savings as well. The plan has four key initiatives: workload sharing, an underwriter model and risk-based processing in production, an account executive model in asset management, and a streamlined organizational model in both HUD headquarters and the field. More information about the plan is available on HUD's website at [http://portal.hud.gov/hudportal/HUD?src=/transforming\\_hud](http://portal.hud.gov/hudportal/HUD?src=/transforming_hud).

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<sup>1</sup> Generally accepted government auditing standards are specified in the Government Accountability Office's (GAO) *Government Auditing Standards*, also referred to as the "Yellow Book." The requirements of the Yellow Book have been incorporated throughout this *Guide* where relevant. *Government Auditing Standards, 2011 Revision*, is discussed beginning at paragraph 104.11.

<sup>2</sup> The *Consolidated Audit Guide for Audits of HUD Programs* (HUD Handbook 2000.04, REV-2) can be accessed from the HUD OIG website at <https://www.hudoig.gov/reports-publications/audit-guides/consolidated-audit-guides>. See the discussion beginning at paragraph 104.21 about the HUD OIG's project to update the HUD audit guide.

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## 103 Participants in HUD Programs

### Project Owners

103.1 **Form of Organization** In the authors' experience, approximately 70% of multifamily housing projects are owned by noncorporate entities—usually partnerships but, in a few instances, sole proprietorships. Approximately 25% of multifamily housing projects are owned by not-for-profit corporations provided tax exempt status under Section 501(c)(3) of the Internal Revenue Code. (The nonprofit projects are typically either owned by national nonprofit organizations, for example, the Salvation Army, or community based charitable groups, for example, the “Council of Presbyterian Churches of XYZ County.”) The remaining 5% of HUD projects are organized as either C or S corporations.

103.2 **Profit-motivated Projects versus Limited Distribution or Nonprofit Projects** Owners of HUD projects can be organized into three broad categories: profit motivated, limited distribution (also referred to as limited dividend),<sup>3</sup> and nonprofit. For HUD regulatory purposes, the distinction between the three is based on whether the project owners are permitted to retain “surplus cash.” *Surplus cash* is a regulatory term that essentially refers to cash in excess of that needed to meet all project expenses and reserve requirements. In the case of profit-motivated projects, all surplus cash generated by the project is available for distribution to project owners. Limited distribution projects, however, must limit distributions to project owners to a specified percentage of the owner's initial equity investment. Nonprofit owners may not be paid distributions of surplus cash. Such projects must deposit surplus cash into a “residual receipts account” that can be used to fund operating deficits in future years.

103.3 The type of project owner (i.e., profit-motivated, limited distribution, or not-for-profit) can vary based on the particular HUD program. For example, although profit-motivated owners may participate in most HUD programs, some programs, such as HUD's capital advance programs for the elderly and the disabled, are restricted to nonprofit owners. Other programs are predominantly available to limited distribution owners, i.e., profit-motivated owners who agree to restrict their surplus cash distributions in exchange for HUD subsidies. On the other hand, many HUD programs allow all three types of owners. Appendix 2A summarizes the types of project owners that are eligible for HUD's multifamily housing programs.

### **Project versus Entity Expenses**

103.4 For financial reporting purposes, HUD requires that *project expenses* be segregated from *entity expenses*. To aid in that segregation, HUD's chart of accounts has separate account numbers for project expenses and entity expenses. Project expenses are expenses incurred in connection with the operation of the

project, i.e. reasonable and necessary to the operation of the project. Entity expenses (sometimes referred to as *mortgagor expenses* or *corporate expenses*) are expenses attributable solely to the entity, for example, officers' salaries, federal and state income taxes, and legal expenses attributable to the entity *per se* (as distinct from the project). Entity expenses can only be paid from mortgagor contributions or surplus cash. (See paragraph 300.10.)

## **Lenders**

103.5 **Private Sector Lenders** The Federal Housing Administration (FHA) insures loans originated by HUD-approved lenders such as banks, savings and loans, and mortgage companies to finance the purchase of single family and multifamily housing. The lenders are subject to periodic review by the Asset Management Branch. Unless they are exempt, lenders that are approved to participate in FHA insurance programs are required to obtain an audit in accordance with the HUD audit guide in order to recertify their eligibility to participate in the programs. This audit requirement is discussed in Chapter 9.

103.6 **Governmental Lenders** The Federal Home Loan Mortgage Corporation (Freddie Mac) and Federal National Mortgage Association (Fannie Mae) purchase loans made by private sector lenders and resell them to investors. By giving lenders an outlet to sell such loans, these governmental lenders encourage more mortgage lending.

## **State Housing Agencies and Indian Housing Authorities**

103.7 State housing agencies issue bonds to finance multifamily housing projects and act as contract administrators for Section 8 rent subsidy projects. As contract administrators, the state agencies perform certain administrative duties on behalf of HUD for a fee. Those duties include providing oversight of project owners and management agents to assure compliance with HUD requirements.

103.8 Indian housing authorities operate much like housing agencies except the Section 8 subsidies are directed toward owners of housing for members of federally-recognized Indian tribes. Like housing agencies, Indian housing authorities serve as contract administrators and provide oversight of project owners to assure compliance with HUD requirements.

103.9 State housing agencies and Indian housing authorities may have their own audit and accounting guidelines, and those guidelines may differ from the HUD audit guide's requirements. In such cases, the auditors need to advise their client of the inconsistencies and meet with HUD and the housing agency or Indian housing authority to determine filing requirements that are acceptable to all concerned.

## **Management Agents**

103.10 HUD projects may be managed by the project's owner, an outside management agent, or, for certain types of projects, a project administrator employed by the project. The project owner is responsible for seeking out and selecting someone to manage the project; however, the decision to self-manage a project or the selection of a management agent must be approved by HUD. Paragraph 206.4 discusses the Management Entity Profile and the Management Certification that project owners must file with the HUD field office to obtain approval of a management agent.

103.11 Management agents provide a variety of services to HUD projects, including marketing the rental units, bookkeeping, building maintenance, and landscaping. Whether the management fee is subject to review by HUD is based on the particular type of project.

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<sup>3</sup> Most accountants, including the authors, prefer using the term *limited distribution owner* instead of *limited dividend owner*. They believe that the term *limited dividend owner* incorrectly suggests that only corporate entities are subject to restrictions on owner payments.

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## 104 Audit and Accounting Guidance Applicable In Audits Of HUD-Assisted Entities

### General Literature

104.1 **GAAS and GAAP** Generally accepted accounting principles that apply to business entities and nonprofit organizations are equally applicable to for-profit or nonprofit entities that own or sponsor HUD programs. Chapter 3 provides an overview of the accounting guidance commonly applicable for HUD entities. Similarly, all of the Statements on Auditing Standards (SASs) and Auditing Interpretations generally applicable to audits of financial statements may apply in HUD engagements. The authoritative auditing standards are discussed when applicable throughout this *Guide*.

### Generally Accepted Auditing Standards

104.2 **Form and Structure of the Auditing Standards** Each auditing standard is divided into the following topics:

- **Introduction.** Includes matters such as the purpose and scope of the guidance, subject matter, effective date, and other introductory material.
- **Objectives.** Establishes objectives that allow the auditor to understand what he or she should achieve under the standards. The auditor uses the objectives to determine whether additional procedures are necessary for their achievement and to evaluate whether sufficient appropriate audit evidence has been obtained.
- **Definitions.** Provides key definitions that are relevant to the standard.
- **Requirements.** States the requirements that the auditor is to follow to achieve the objectives unless the standard is not relevant or the requirement is conditional and the condition does not exist.

- **Application and Other Explanatory Material.** Provides further guidance to the auditor in applying or understanding the requirements. While this material does not in itself impose a requirement, auditors should understand this guidance. How it is applied will depend on professional judgment in the circumstances considering the objectives of the standard. The requirements section references the applicable application and explanatory material. Also, when appropriate, considerations relating to smaller and less complex entities are included in this section.

104.3 A standard may also contain exhibits or appendices. Appendices to a standard are part of the application and other explanatory material. The purpose and intended use of an appendix is explained in the standard or in the title and introduction of the appendix. Exhibits to standards are interpretive publications. Interpretive publications are not auditing standards and do not contain requirements. Rather, they are recommendations on applying the standards in particular circumstances that are issued under the authority of the Auditing Standards Board. Auditors are required to consider applicable interpretive publications when planning and performing the audit.

104.4 **AU-C Section Organization** Within the AICPA Professional Standards, the auditing standards use “AU-C” section numbers. The organization of the AU-C sections is as follows:

- Preface.
- Glossary.
- AU-C Section 200-299, *General Principles and Responsibilities*.
- AU-C Section 300-499, *Risk Assessment and Response to Assessed Risks*.
- AU-C Section 500-599, *Audit Evidence*.
- AU-C Section 600-699, *Using the Work of Others*.
- AU-C Section 700-799, *Audit Conclusions and Reporting*.
- AU-C Section 800-899, *Special Considerations*.
- AU-C Section 900-999, *Special Considerations in the United States*.

- Exhibits and Appendixes.

### **AICPA Code of Professional Conduct**

104.5 The AICPA *Code of Professional Conduct* provides guidance and rules that auditors need to comply with in connection with an audit engagement. As noted in AU-C 220.A4, the *Code of Professional Conduct* sets forth the fundamental principles of professional ethics, including objectivity and independence. The *Code of Professional Conduct* is discussed in section 400.

104.6 AU-C 200.15 states the auditor is required to be independent when performing an audit in accordance with GAAS. Independence requirements are discussed in section 401. AU-C 200.16 also requires auditors to follow ethical requirements that are relevant to the engagement.

### **Government Auditing Standards**

104.7 Audits of HUD programs are conducted in accordance with generally accepted government auditing standards (GAGAS) as specified in the Government Accountability Office's (GAO), *Government Auditing Standards*, often referred to as the "Yellow Book." The Yellow Book standards relate to scope and quality of audit efforts and to the characteristics of a professional and meaningful audit report. As stated in Paragraph 1.04 of the Yellow Book, GAGAS "provide a framework for conducting high quality audits with competence, integrity, objectivity, and independence." They address the concerns of public officials, legislators, and the general public about whether governmental funds are handled properly and in compliance with existing laws and whether governmental programs are being conducted efficiently, effectively, and economically.

104.8 GAGAS recognize that the AICPA has adopted standards and procedures applicable to audits performed to express opinions on whether financial statements fairly present the financial position and results of operations. For financial audits, the Yellow Book incorporates the AICPA's field work and reporting standards and the related SASs, unless they are specifically excluded or modified. However, *Government Auditing Standards* fulfill broader interests and are identified as standards for "broad scope" auditing. The standards identify the ethical principles that are the foundation of governmental audits and establish requirements for the scope of audit work, auditor qualifications and independence, competence of the audit staff, exercise of professional judgment, and quality control and external peer reviews, as well as standards for planning, supervision, and reporting.

104.9 GAGAS has no authority on its own. In other words, the GAO provides government auditing standards in the Yellow Book, but has no authority to require compliance with them. As stated in Paragraph 1.06 of the Yellow Book:

Provisions of laws, regulations, contracts, grant agreements, or policies frequently require audits be conducted in accordance with GAGAS . . . The requirements and guidance in GAGAS apply to audits of government entities, programs, activities, and functions, and of government assistance administered by contractors, nonprofit entities, and other nongovernmental entities when the use of GAGAS is required or is voluntarily followed.

104.10 In audits of HUD programs, compliance with the Yellow Book is required by HUD's *Consolidated Audit Guide for Audits of HUD Programs* for for-profit entities, and the Single Audit Act for nonprofit entities. The Yellow Book is available in PPC's *Government Documents Library* at Gov. Doc. No. 2. <sup>4</sup>

104.11 **Government Auditing Standards, 2011 Revision** In December 2011, the GAO issued *Government Auditing Standards, 2011 Revision* (Yellow Book). When performing Yellow Book audits, the auditor has certain responsibilities beyond those of audits performed in accordance with GAAS. For example, in addition to an auditor's report that expresses an opinion or disclaimer of opinion on the financial statements as required by GAAS, the Yellow Book requires a written report on internal control over financial reporting and on compliance and other matters. The Yellow Book standards and guidance applicable to financial audits are contained in chapters 1 through 4 of *Government Auditing Standards* and include ethical principles, general standards, and additional standards for performing and reporting on financial audits.

104.12 Chapter 1—Government Auditing: Foundation and Ethical Principles. Chapter 1 includes the introduction and the foundation and overarching ethical principles of government auditing. The ethical principles do not establish specific standards or requirements; however, they provide the foundation, discipline, and structure that affect the application of *Government Auditing Standards*. The ethical principles relate to preserving auditor independence, taking on only work that the audit organization is competent to perform, performing high-quality work, and following the standards cited in the auditor's report.

104.13 Chapter 2—Standards for the Use and Application of GAGAS. Chapter 2 provides an overall discussion on the use and application of *Government Auditing Standards*. Among other things, it emphasizes the role of professional judgment in determining the appropriate type of statement to be used for stating compliance with *Government Auditing Standards* in the auditors' report and defines two categories of professional requirements to describe auditors' responsibilities. (See paragraph 401.1.) Chapter 2 also explains that interpretative publications issued by the GAO to provide guidance on the application of *Government Auditing Standards* in specific circumstances, while not auditing standards, have the same level of authority as application and other explanatory material in the Yellow Book.

104.14 Chapter 3—General Standards. Chapter 3 contains the Yellow Book's general standards, which along with the overarching ethical principles in Chapter 1, establish a foundation for the credibility of auditors' work. The general standards relate to independence, professional judgment, competence, and quality control and assurance.

104.15 Chapter 3 also establishes a conceptual framework approach for independence to provide a way for auditors to assess their independence in unique circumstances that may exist and are not expressly prohibited by the Yellow Book. Under the conceptual framework, the auditor identifies and evaluates threats to independence and determines if safeguards can be put in place to mitigate significant threats. (Safeguards are controls that eliminate threats or reduce them to an acceptable level.) The conceptual framework is applied at the audit organization, engagement, and individual auditor levels. However, certain specific nonaudit services are prohibited. See the discussion in section 401.

104.16 Chapter 4—Standards for Financial Audits. Chapter 4 contains requirements and considerations for both performing and reporting on financial audits conducted in accordance with *Government Auditing Standards*. It incorporates, by reference, the AICPA's performance and reporting standards and the corresponding Statements on Auditing Standards. All sections of the SASs are incorporated, including the introduction, objectives, definitions, requirements, and application and other explanatory material.

104.17 Certain AICPA standards that may have unique considerations in the government environment, include the following:

- *Materiality*. It may be appropriate to use a lower materiality level in Yellow Book audits than in non-Yellow Book audits due to (a) the public accountability of government entities and entities receiving government

funding, (b) various legal and regulatory requirements, and (c) the visibility and sensitivity of government programs.

- *Early Communication of Control Deficiencies.* Early communication is important for some internal control deficiencies because of the significance and urgency for corrective action. When a deficiency is communicated early, it still must be included in the report on internal control and compliance the auditor issues at the end of the audit.

104.18 Yellow Book reporting requirements that extend beyond that of the AICPA relate to:

- Reporting the auditors' compliance with *Government Auditing Standards*.
- Reporting on internal control and compliance with provisions of laws, regulations, contracts, and grant agreements.
- Communicating deficiencies in internal control; fraud; noncompliance with provisions of laws, regulations, contracts, grant agreements; and abuse.
- Reporting views of responsible officials.
- Reporting confidential or sensitive information.
- Distributing reports.

104.19 Yellow Book requirements for performing a financial audit that extend beyond those of the AICPA include requirements relating to:

- Auditor communication.
- Previous audits and attestation engagements.
- Fraud, noncompliance, and abuse.

- Developing elements of a finding.

- Audit documentation.

104.20 The requirements and guidance contained in Chapters 1 through 4 of *Government Auditing Standards* are discussed throughout this *Guide*.

## HUD Literature

104.21 **HUD Audit Guide, Applicable for For-profit Audits** In addition to GAAS and GAGAS, audits of for-profit HUD-assisted entities also must comply with the HUD audit guide issued by the HUD Office of Inspector General. The *Consolidated Audit Guide for Audits of HUD Programs* (HUD Handbook 2000.04 REV-2), was originally issued in December 2001. Since the time the handbook was issued in its entirety in 2001, the HUD OIG has incorporated changes in the professional standards and regulatory environment by periodically issuing updates of individual chapters, known as changes. As of the date this *Guide* was completed, the HUD OIG had revised and released all seven of the audit guide chapters at least once. Previously, HUD OIG stated that when all of the individual chapters of the HUD audit guide were revised, they would be consolidated into a revised audit guide and issued as HUD Handbook 2000.04 REV-3. However, HUD OIG has not announced the timing for issuance of a new consolidated audit guide.<sup>5</sup>

104.22 The HUD audit guide, among other things, requires auditors to perform sufficient audit procedures to issue an opinion as to whether the HUD-assisted entity complied with laws, regulations and the provisions of contracts or grant agreements that could have a direct and material effect on the entity's major HUD programs. Highlights of the HUD audit guide include the following:

a. *Procedures for Testing the Entity's Compliance with Laws and Regulations Affecting Major HUD-assisted Programs.* The HUD audit guide includes suggested audit procedures for testing specific compliance requirements applicable to major HUD programs.

b. *Requirement to Test Internal Control over Compliance for Major HUD Programs.* The HUD audit guide states that auditors should perform tests of controls "to evaluate the effectiveness of the design and operation of internal controls in preventing or detecting material noncompliance with the direct and material requirements of the major HUD-assisted programs" [HUD audit guide, Paragraph 1-3(B)].

c. *Basic Financial Statements and Supplementary Information.* The HUD audit guide describes the supplementary information that must be presented with the basic financial statements. Generally, an entity's financial statements must be submitted to HUD within 90 days after the end of the its fiscal year.

d. *Auditor's Reports.* The HUD audit guide discusses the auditor's reporting responsibilities and provides report examples.

e. *Auditor and Client-prepared Schedules.* The HUD audit guide specifies additional separate schedules that are to accompany the financial statements and auditor's reports. It describes the form and content of the schedule of findings, questioned costs, and recommendations that is prepared by the auditor; the schedule of the status of prior audit findings, questioned costs, and recommendations; and the corrective action plan that are prepared by management of the HUD entity.

104.23 As of the date of this *Guide*, the dates of the most recent issuances and the topics covered by each chapter of the HUD audit guide are effective as follows:

- *Chapter 1, "General Audit Guidance."* This chapter was issued in May 2013 and was effective for audits of fiscal years ending on or after June 30, 2013. Chapter 1 provides an overview of the purpose of the HUD audit guide and various audit performance, communication, and reporting requirements. Chapter 1 provides general guidance applicable for compliance audits performed in accordance with Chapters 3 through 7 of the HUD audit guide. Because of its general nature, the guidance in Chapter 1 affects many aspects of HUD audits; it is discussed where applicable throughout this *Guide*.

- *Chapter 2, "Reporting Requirements and Sample Reports."* This chapter was issued in January 2013 and was effective for audits of fiscal years ending on or after March 31, 2013. Chapter 2 provides general guidance for the reports and schedules that are issued in the compliance audit performed in accordance with Chapters 3 through 7 of the HUD audit guide. Chapter 8 of this *Guide* discusses the auditor's reporting responsibilities.

- *Chapter 3, "HUD Multifamily Housing Programs."* The latest version of this chapter was issued in July 2008. Chapter 3 provides the compliance requirements and suggested audit procedures for testing the entity's compliance with requirements governing multifamily HUD programs. It also requires auditors to test controls to evaluate the effectiveness of the design and operation of internal control in preventing or detecting material noncompliance with the requirements of HUD programs. Chapter 7 of this *Guide* discusses Chapter 3 of the HUD audit guide.

- *Chapter 4, "Mortgage Insurance for Hospitals Program."* The latest version of this chapter was issued in September 2014. Chapter 4 provides interim audit guidance for the HUD multifamily hospital program while HUD revises the chapter in its entirety. This *Guide* does not provide guidance for audits of the HUD multifamily hospital program.

- *Chapter 5, "Development Cost Certification Audit Guidance."* This chapter was issued in March 2007. See paragraph 107.8 for a discussion about the limited guidance for cost certification audits provided in this *Guide*.

- *Chapter 6, "Ginnie Mae Issuers of Mortgage-Backed Securities Audit Guidance."* This chapter provides guidance to auditors of lenders who participate in GNMA's mortgage-backed securities program. A revision

of this chapter was issued in April 2013 and was effective upon issuance. This *Guide* does not discuss audits of lenders in this program.

- *Chapter 7, "FHA-Approved Lenders Audit Guidance."* A major revision of this chapter was issued in December 2012 and was effective for audits of fiscal years ending on or after December 31, 2012. In May 2014 HUD issued a minor update of the chapter to reflect a change in the electronic report submission process. This revision was effective upon issuance. See paragraph 107.5 for a discussion about the limited guidance for audits of FHA-approved lenders provided in this *Guide*. The guidance in Chapter 7 of the HUD audit guide is discussed in more detail in Chapter 9.

104.24 Revisions to the HUD Audit Guide. Because of the relevance to auditors of HUD entities, the following paragraphs present an overview of the changes in the most recent revisions of chapters 1 and 2 of the HUD audit guide.

104.25 The revisions of Chapter 1 of the HUD audit guide issued in 2013<sup>6</sup> clarified or eliminated certain guidance in an April 2011 issuance of the chapter that created practice issues related primarily to (a) using the HUD audit guide for Single Audits, (b) sampling methodology, and (c) reporting noncompliance. Other significant changes are summarized as follows: (paragraph references refer to the currently effective Chapter 1 of the HUD audit guide):

- Clarification that use of the HUD audit guide is mandatory for audits of for-profit HUD entities subject to either HUD's Uniform Financial Reporting Standards (UFRS) or other HUD rules for participation in FHA insurance programs. (Paragraph 1-1)
- Clarification that audits performed in accordance with the HUD audit guide consist of two components: (a) the audit of the entity's financial statements, and (b) a compliance audit of the entity's major HUD programs. The requirements in the HUD audit guide pertain to the compliance audit. (Paragraph 1-1)
- Compliance audits of nonprofit HUD-assisted entities are generally performed in accordance with OMB Single Audit guidance rather than the HUD audit guide. Auditors should only use the compliance requirements and suggested audit procedures in the HUD audit guide to build a compliance audit program in accordance with Part 7 of the Compliance Supplement when a HUD program is not included in the Compliance Supplement. (Paragraph 1-2)
- Discussion of the scope and approach used for the financial statement and compliance audit components of the HUD audit is streamlined to eliminate guidance that conflicts with other authoritative standards. (Paragraph 1-3)
- Criteria for major program determination for each specific HUD audit guide chapter (Chapters 3 through 7) are updated for current requirements. (Paragraph 1-3)



- Sampling guidance is revised. (Paragraph 1-4) See the discussion beginning at paragraph 104.26.
- Guidance for planning the audit (Paragraph 1-5), withdrawing from or terminating the audit engagement (Paragraph 1-6), and quality control review of audits (Paragraph 1-7) are streamlined and conflicting guidance is removed.
- New guidance about peer review requirements is added. (Paragraph 1-8)
- Previous guidance about reporting fraud or noncompliance, the auditor's qualifications, and other matters that was either duplicative of or conflicted with guidance in GAAS, the Yellow Book, or other chapters of the HUD audit guide, is eliminated.

104.26 The revisions to Chapter 1 of the HUD audit guide also clarified the sampling guidance in Appendix A, "Attribute Sampling," of the chapter. Also, the new guidance allows auditors to substitute a sampling approach from the GAS/SA Audit Guide for the methodology outlined in Appendix A to Chapter 1 of the HUD audit guide as long as the resulting sample size is equal to or greater to the minimum sizes stated in that appendix. Paragraph 1-5(B) of the HUD audit guide contains additional guidance that allows the auditor to use dual-purpose samples in audit procedures to test both compliance and internal controls over compliance. Using the guidance in Appendix A to Chapter 1 of the HUD audit guide is discussed in more detail in sections 712 and 713.

104.27 The most important change in the revision of *Chapter 2 of the HUD audit guide*, released in January 2013, was the restructuring of the auditor's reporting requirements. Accordingly, the general format of the auditors' reports issued in a HUD audit of a for-profit HUD-assisted entity is the same as the format of the reports issued in a Single Audit of a nonprofit HUD-assisted entity. That is, when the auditor reports on compliance and internal control over compliance, the HUD audit guide suggests the following:

- Independent auditor's report on internal control over financial reporting and on compliance and other matters based on an audit of the financial statements performed in accordance with *Government Auditing Standards*.
- Independent auditor's report on compliance with requirements that could have a direct and material effect on each major HUD program and on internal control over compliance based on an audit in accordance with the HUD audit guide.

As a result of adopting the new reporting structure, HUD eliminated the previous requirements for the auditor to report separately on compliance with respect to nonmajor HUD program requirements and on compliance with specific requirements applicable to fair housing and nondiscrimination. Paragraph 2-6 of the HUD audit guide

provides examples that illustrate the auditor's reports that are issued in accordance with the revised reporting structure.

104.28 Chapter 2 of the HUD audit guide provides extensive guidance that covers additional topics related to reporting matters such as—

- Report issuance and distribution.
  
- Instructions for the other schedules prepared by the auditor or management that are part of the required reporting package. That is, the schedule of findings, questioned costs, and recommendations; the schedule of the status of prior audit findings, questioned costs, and recommendations; and the corrective action plan.
  
- Illustrative examples of the other schedules prepared by the auditor or management.
  
- Responsibilities with respect to fraud or equity skimming that have occurred or are likely to have occurred.
  
- Management letters.

104.29 The requirements in Chapter 2 of the HUD audit guide are discussed in greater detail and illustrated in Chapter 8 and the appendixes to Chapter 8 of this *Guide*.

**104.30 HUD Handbook—*Financial Operations and Accounting Procedures for Insured Multifamily Projects*** HUD Handbook, *Financial Operations and Accounting Procedures for Insured Multifamily Projects* (HUD Handbook 4370.2 REV-1, CHG-1), provides accounting guidance for most HUD-insured multifamily projects. The handbook has not been updated to reflect changes in authoritative standards or the changes in the financial reporting standards documented on the REAC website (see Appendix 1A and section 311). HUD has not provided a timeline for updating this handbook, therefore the authors recommend that auditors be alert for the issuance of a revised handbook. In the meantime, the authors believe that the information posted on the REAC website should be followed even if it conflicts with the HUD handbook. (See Chapter 3 of this *Guide* for guidance on preparing HUD financial statements.)

104.31 Important notices about technology changes, submission procedures, accounting requirements, and other developments relating to multifamily housing projects are posted to REAC's webpage devoted to multifamily housing news at [http://portal.hud.gov/hudportal/HUD?src=/program\\_offices/public\\_indian\\_housing/react/products/prodmf#fass-audit](http://portal.hud.gov/hudportal/HUD?src=/program_offices/public_indian_housing/react/products/prodmf#fass-audit). Accountants and auditors can monitor this webpage for current information about electronic submission requirements and links to useful resources. In addition, the authors believe the following documents are especially helpful for project owners and auditors of multifamily programs. Links to the documents can be found at [http://portal.hud.gov/hudportal/HUD?src=/program\\_offices/public\\_indian\\_housing/react/library/lib\\_famf](http://portal.hud.gov/hudportal/HUD?src=/program_offices/public_indian_housing/react/library/lib_famf).

- Industry User Guide for the Financial Assessment Subsystem-Multifamily Housing (FASSUB User Guide).<sup>7</sup>

- *Summary of Financial Reporting and Auditing Guidance for HUD Multifamily Program Participants and Independent Auditors* (February 2003).

- *Submission and Review Requirements and REMS Data Dependencies for Annual Financial Statements* (June 2002).

- *Guidelines on Reporting and Attestation Requirements of Uniform Financial Reporting Standards (UFRS)* (March 2001).

While not setting new requirements or replacing existing requirements contained in the HUD handbooks, they do summarize many of the accounting, annual financial reporting, and auditing requirements of multifamily programs.

104.32 **Other HUD Handbooks** HUD has issued a number of handbooks in addition to the HUD audit guide and the handbooks listed in paragraph 104.31. Exhibit 1-1 is a list of HUD handbooks applicable to HUD-assisted project owners.

**Exhibit 1-1**

**HUD Handbooks  
Applicable to HUD-assisted Project Owners  
(as of August 2015)<sup>a</sup>**

<b>Handbook No.</b>	<b>Issue Date or Date of Latest Change</b>	<b>Title</b>
<b>Accounting and Auditing Handbooks:</b>		
IG 2000.04 REV-2 <sup>b</sup>	9/14	<i>Consolidated Audit Guide for Audits of HUD Programs</i>
4370.1 REV-2	8/95	<i>Reviewing Annual and Monthly Financial Reports</i>
4370.2 REV-1	1/23/96	<i>Financial Operations and Accounting Procedures for Insured Multifamily Projects</i>
4370.3	6/30/92	<i>Uniform System of Accounts for Cooperative Housing Corporations Using Manual and Computer Accounting Systems</i>

4370.4 REV-1	6/24/92	<i>Basic Accounting Desk Reference for HUD Loan Servicers</i>
<b>Other Handbooks:</b>		
4350.1 REV-1 <sup>c</sup>	8/31/12	<i>Multifamily Asset Management and Project Servicing</i>
4350.2 REV-1	8/20/93	<i>Section 8 Loan Management Set Aside Program for Projects with HUD-Insured and HUD-Held Mortgages</i>
4350.3 REV-1	11/2013	<i>Occupancy Requirements of Subsidized Multifamily Housing Programs</i>
4350.5	6/14/94	<i>Subsidy Contract Administration and Field Monitoring</i>
4350.6	8/7/95	<i>Processing Plans of Action Under the Low Income Housing Preservation and Resident Homeownership Act of 1990</i>
4355.1 REV-1	5/29/92	<i>Flexible Subsidy</i>
4381.5 REV-2	6/8/06	<i>Management Agent Handbook</i>
4566.2	8/95	<i>Management, Servicing and Disposition Requirements for Projects with 223(f) Coinsured Loans</i>
4571.1 REV-2	3/83	<i>Section 202 Direct Loan Programs for Housing for the Elderly or Handicapped</i>
4571.2	6/3/91	<i>Section 811 Supportive Housing for Persons with Disabilities</i>
4571.3 REV-1	4/9/93	<i>Supportive Housing for the Elderly Section 202 Program</i>
4571.4	6/7/94	<i>Supportive Housing for Persons with Disabilities, Conditional Commitment—Final Closing</i>

**Notes:**

<sup>a</sup> HUD handbooks are all available online and can be viewed or downloaded from HUD's website. The web page at <http://portal.hud.gov/> provides links to HUD handbooks, forms, and publications.

<sup>b</sup> See the discussion beginning at paragraph 104.21 about the current status of the HUD OIG's program to update the HUD audit guide. A link to the HUD audit guide is available at [www.hudoig.gov/reports-publications/audit-guides/consolidated-audit-guides](http://www.hudoig.gov/reports-publications/audit-guides/consolidated-audit-guides).

<sup>c</sup> HUD has issued revisions to Chapters 6, 9, 14, and 38 of Handbook 4350.1.

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104.33 **HUD Internet Sites** Most of the information discussed in section 104, as well as other HUD information and forms, can be obtained from various sites on the Internet. Appendix 1A contains a listing of sites containing HUD information that the authors have found useful. A short description of the information available from each site follows the website address.

**Single Audit Act and OMB's Uniform Administrative Requirements, Cost Principles, and Audit**

## **Requirements for Federal Awards, Applicable for Nonprofit Audits**

104.34 Nonprofit entities that participate in HUD programs are included in the scope of the amended Single Audit Act and OMB's *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* which supersedes eight OMB Circulars including OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. The new audit requirements in the Uniform Guidance are effective for audits of fiscal years beginning on or after December 26, 2014. This *Guide* has been updated to reflect the requirements of the Uniform Guidance, which is applicable for audits of periods ending on December 31, 2015, or later.

104.35 The provisions of the Uniform Guidance differ from those in the HUD audit guide (see paragraph 104.21) in the following primary areas:

- Audit threshold.
  
- Major program determination.
  
- Source of compliance requirements.
  
- Form of reporting audit findings and threshold for determination of questioned costs.
  
- Requirement to submit the schedule of expenditures of federal awards.
  
- Requirements when sampling is used in testing compliance or internal control over compliance.
  
- Form and content of the schedules of prior year audit findings and corrective action plan.
  
- Submission of reports to the Federal Audit Clearinghouse.
  
- Requirement to submit the data collection form.
  
- Report due dates.

See section 714 for a discussion of the unique aspects of performing a Single Audit in accordance with the Uniform Guidance.

104.36 The differences between audits performed in accordance with the HUD audit guide and OMB's Uniform Guidance necessitate customizing certain practice aids provided in this *Guide*, such as the engagement and representation letters, and compliance audit programs for nonprofit entities. The practice aids for nonprofit HUD entities are listed in the instructions to sections HUD-CL, HUD-CX, and HUD-AP. Auditors need to use caution when selecting the proper practice aids for nonprofit HUD-assisted entities.

### **AICPA Audit Guide**

104.37 The AICPA Audit Guide, *Government Auditing Standards and Single Audits* (the GAS/SA Audit Guide) provides guidance for: (a) financial statement audits performed under *Government Auditing Standards* (Part I), (b) audits conducted in accordance with the Single Audit Act and OMB Circular A-133 (Part II), and (c) audits conducted in accordance with the Single Audit Act and the Uniform Guidance (Part III). The February 2015 edition of the GAS/SA Audit Guide includes the new guidance in Part III for audits performed in accordance with the Uniform Guidance. As noted in paragraph 104.34, the new audit requirements in the Uniform Guidance are effective for audits of fiscal years beginning on or after December 26, 2014.

104.38 The guidance in Part I of the GAS/SA Audit Guide for performing audits in accordance with *Government Auditing Standards* applies to *all* HUD audits. Guidance for audits conducted under the Single Audit Act and the OMB's Uniform Guidance is provided in Part III (Chapters 15 to 24) of the GAS/SA Audit Guide. This guidance directly applies to Single Audits of nonprofit HUD-assisted entities.

104.39 While the guidance in Part III of the GAS/SA Audit Guide is not directly applicable to audits of for-profit HUD entities because the compliance audit for those entities is performed in accordance with the HUD audit guide rather than the Uniform Guidance, the authors believe much of the general guidance in those chapters on aspects of compliance audits also should be considered in for-profit audits. Accordingly, the guidance provided by the GAS/SA Audit Guide is incorporated in this *Guide* where applicable.

### **PPC's Government Documents Library**

104.40 In order to provide our subscribers with the most recent government documents, a compendium of government documents is provided in *PPC's Government Documents Library* (Library). The Library is available on Checkpoint and may be accessed free of charge. (Customers who do not have Checkpoint access to this *Guide* and would like to request free access to the Library should send an email to [rg.customerservice@thomsonreuters.com](mailto:rg.customerservice@thomsonreuters.com). Detailed instructions on obtaining free access to the Library are included with the print and DVD editions of this *Guide*.) The authors update the website version of the Library periodically—as necessary to keep the documents current. Appendix 1B lists the documents that are included in the Library at this date. References in this *Guide* to documents included in the Library are indicated by Gov. Doc. No. XX.

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<sup>4</sup> A compendium of government documents is provided in *PPC's Government Documents Library*. See paragraph 104.40 and Appendix 1B.

<sup>5</sup> Auditors can monitor the release of new chapters and other developments in this area at the AICPA's Governmental Audit Quality Center website at [www.aicpa.org/InterestAreas/GovernmentalAuditQuality/Resources/HUDInformation/Pages/default.aspx](http://www.aicpa.org/InterestAreas/GovernmentalAuditQuality/Resources/HUDInformation/Pages/default.aspx). The HUD audit guide and updated chapters are available on the HUD OIG's website at <http://www.hudoig.gov/reports-publications/audit-guides/consolidated-audit-guides>.

<sup>6</sup> The revisions to Chapter 1 of the HUD audit guide were issued in January 2013 as Handbook 2000.04 REV-2, CHG-14 and in May 2013 as Handbook 2000.04 REV-2, CHG-17. CHG-14 only revised the guidance in paragraph 1-5 of the HUD audit guide about major program determination that was necessary due to the change in major program reporting when Chapter 2 of the HUD audit guide was revised. See paragraph 104.27. The revision of Chapter 1 of the HUD audit guide issued in May 2013 (CHG-17) contains the substantial changes discussed in this paragraph.

<sup>7</sup> As of the date of this *Guide*, the FASSUB User Guide (version 7.2.3.0 released in June 2015) had not been updated for changes that may be required for audits of nonprofit HUD-assisted entities performed in accordance with OMB's *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, which supersedes OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*, effective for audits of fiscal years beginning on or after December 26, 2014 (that is, for fiscal years ended December 31, 2015 or later). Auditors should monitor REAC's website at [portal.hud.gov/hudportal/HUD?src=/program\\_offices/public\\_indian\\_housing/react/products/prodmf](http://portal.hud.gov/hudportal/HUD?src=/program_offices/public_indian_housing/react/products/prodmf) for notices that could affect their December 31, 2015 audits. The Uniform Guidance is discussed in section 714.

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## 105 Accountants' Involvement with HUD Clients

### How Are Auditors Selected?

105.1 HUD Handbook 4370.2 REV-1, Paragraph 3-1, states that owners of HUD-assisted projects should use competitive bidding when selecting an auditor. The bidding process can vary based on the size and needs of the project and may range from simple telephone bidding (of at least three auditors) to a request for proposal (RFP).

105.2 Auditors interested in participating in the selection process may contact their area HUD field offices, which maintain a database of all existing and development stage HUD projects. Many HUD field offices also list the projects under their supervision on the Internet. Also, as stated in paragraph 102.4, the Division of Elderly and Assisted Housing will, upon request, provide information on prospective projects for the elderly and disabled, which auditors can use for practice development purposes.

### Other Opportunities for Client Service

105.3 As construction of a project nears completion, developers must submit to HUD "cut-off" financial statements and a "Mortgagor's Certificate of Actual Costs" (Form HUD-92330). Audits of the financial statements and Form HUD-92330 are called *cost certification audits*. Chapter 5 of the HUD audit guide provides guidance on performing cost certification audits. *PPC's Guide to HUD Audits* does not provide detailed guidance on performing cost certification audits. However, section 812 of this *Guide* discusses factors to consider when reporting the results of a cost certification audit and includes an illustrative auditor's report. Also, the authors have provided the practice aid at HUD-CX-11.4, "Cost Certification Audit Checklist," to assist auditors with cost certification engagements.

105.4 Other opportunities for client service that should not be overlooked include assisting the client to complete and electronically submit the project owner's financial report to HUD's REAC, performing the required agreed-upon procedure engagement relating to the electronic submission (see section 811), or preparing the tax return for the entity that owns the HUD project.<sup>8</sup>

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<sup>8</sup> Auditors should be aware that the performance of consulting or nonaudit services may impair their independence under *Government Auditing Standards*. See the discussion about independence requirements in section 401.



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## **106 The PPC Audit Process**

106.1 Generally accepted auditing standards require auditors to use information gathered about the entity and its environment (including internal control) to identify and assess the risks of material misstatement at both the overall financial statement and relevant assertion levels, and to determine the nature, timing, and extent of further audit procedures needed to respond to those risks. Further audit procedures are required to be performed to obtain audit evidence to support the auditor's opinion.

106.2 The authors have developed a practical approach to that audit process to address the requirements of authoritative literature and have designed practice aids to assist auditors in meeting those requirements. PPC's audit approach is designed to be flexible and adaptable, allowing auditors to better leverage their knowledge of the client to tailor their audit procedures. PPC has tailored this approach for use in all of our industry audit guides so that auditors can use a common audit approach in all of their audits. The audit approach has been divided into the following broad steps:

- 1 Perform procedures regarding acceptance/continuance of the client relationship, evaluate compliance with ethical requirements (including independence), and establish an understanding with the client in an engagement letter.
- 2 Develop a preliminary audit strategy, establish planning materiality and perform risk assessment procedures to gather information about the entity and its environment that may be relevant in identifying risks of material misstatement/noncompliance.
- 3 Gather the information to understand and evaluate the design and implementation of the entity's internal control system.
- 4 Synthesize the information gathered, identify risks (both overall and specific risks) that could result in material misstatement/noncompliance and finalize the overall audit strategy.
- 5 Assess the risks of material misstatement of the entity's financial statements.

6 Develop and perform appropriate responses (further audit procedures) to the assessed risks of material misstatement/noncompliance considering the overall audit strategy and planning materiality.

7 Evaluate audit findings and evidence.

8 Prepare required reports and communications.

106.3 Although the requirements and guidance may suggest a sequential process, the audit is a continuous process of gathering, updating, and analyzing information about the fairness of presentation of amounts and disclosures in the client's financial statements. Therefore, the audit process is an iterative, nonlinear process, whereby the required procedures may be performed concurrently with other procedures. In addition, risks should be evaluated continuously throughout the audit.

#### **Practice Aids**

106.4 *PPC's Guide to HUD Audits* contains practice aids that guide the auditor through the entire audit process. The practice aids included in this *Guide* are discussed in the related text guidance.

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## 107 Organization and Scope of *PPC's Guide to HUD Audits*

107.1 Accountants who are familiar with *PPC's Guide to Audits of Nonpublic Companies* will see similarities between it and this *Guide*. This *Guide* tailors the guidance in *PPC's Guide to Audits of Nonpublic Companies* to HUD engagements. It also adopts applicable guidance from *PPC's Guide to Single Audits*, *PPC's Guide to Audits of Nonprofit Organizations*, and *PPC's Guide to Real Estate* and tailors it to HUD engagements. Although *PPC's Guide to HUD Audits* is designed to be freestanding and used independently, auditors may need to consult other PPC guides for in-depth guidance about other specialized types of audits or complex financial reporting and presentation issues.

107.2 While audits of HUD-assisted multifamily housing projects is the primary focus of this *Guide*, as discussed in the following paragraphs, this *Guide* also provides guidance for audits of other HUD-assisted entities and other types of engagements. The audit of HUD-assisted entities generally consists of two components: the financial statement audit and the compliance audit. The compliance portion of the audit assists HUD in determining whether the HUD-assisted entity has complied with all of the requirements of the HUD program and has correctly utilized program funds. The compliance audit procedures are designed to test compliance with HUD program requirements and allow the auditor to express an opinion on the entity's compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on each of its major HUD programs.

### **Audits of HUD-assisted Multifamily Housing Projects**

107.3 Chapters 1 through 8 focus on HUD-assisted multifamily housing projects owned by for-profit entities and nonprofit entities. Those chapters (a) provide practical guidance on applying the requirements of generally accepted auditing standards (GAAS), *Government Auditing Standards*, and the *Consolidated Audit Guide for Audits of HUD Programs* or OMB's *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*,<sup>9</sup> as applicable, and (b) highlight the provisions of other guidance applicable to audits of HUD projects, such as in HUD regulations and handbooks. The chapters discuss HUD regulatory provisions, contracts, and forms; HUD accounting considerations and financial statement presentation; pre-engagement activities and audit planning; performing substantive procedures; concluding the audit; auditing compliance with laws and regulations; and auditor's reports and other communications. There are numerous practice aids throughout this *Guide* specifically tailored to audits of HUD-assisted project owners, such as confirmation letters and compliance checklists.

107.4 **Sources of Compliance Requirements** The source of the appropriate compliance requirements to be used for the compliance audit portion of a HUD audit depends on whether the entity is a *for-profit* or a *nonprofit*

entity. For for-profit HUD-assisted multifamily entities, the compliance requirements are specified in Chapter 3, “HUD Multifamily Housing Programs,” of the HUD audit guide. On the other hand, auditors of nonprofit HUD entities are directed by the Uniform Guidance at 2 CFR 200.514(d) to determine the compliance requirements for major program testing using the Compliance Supplement.<sup>10</sup> Guidance for performing compliance audits of both for-profit and nonprofit HUD entities is discussed in Chapter 7.

### **Compliance Audit Guidance for Audits of FHA-approved Lenders**

107.5 Chapter 9 focuses on compliance audits of nonsupervised and supervised lenders that participate in the FHA’s single-family and multifamily housing insurance programs. Its objective is to assist auditors in complying with the compliance provisions contained in Chapter 7 of the HUD audit guide.

107.6 *However, Chapter 9 of this Guide does not provide comprehensive guidance about accepting, planning, executing, or reporting in an audit of a lender that participates in FHA insurance programs. PPC’s Guide to Audits of Financial Institutions covers all key areas of a financial institution audit and also contains a comprehensive set of audit programs, checklists, confirmation forms, questionnaires, and other practice aids that have been tailored to the unique aspects of financial institution audits. The guide can be ordered by calling (800) 431-9025 or from the Thomson Reuters website at [tax.thomsonreuters.com](http://tax.thomsonreuters.com).*

### **Low Income Housing Tax Credit Projects**

107.7 Chapter 10 provides an overview of the Low Income Housing Tax Credit (LIHTC) regulations, explains the services that auditors may provide for these projects, and discusses compliance issues related to ongoing and initial project completion. The chapter also presents illustrative report examples for audit and agreed-upon procedures engagements for LIHTC projects. However, Chapter 10 of this *Guide* does not provide comprehensive guidance about accepting, planning, executing, or reporting in an engagement to provide services related to the LIHTC.

### **Cost Certification Audits**

107.8 This *Guide* provides limited guidance on performing cost certification audits. Section 812 discusses some important factors to consider when reporting the results of a cost certification audit. However, Chapter 8 of this *Guide* does not provide comprehensive guidance about accepting, planning, executing, or reporting in a cost certification audit engagement. The practice aid at HUD-CX-11.4, “Cost Certification Audit Checklist,” is designed to assist auditors with cost certification engagements. An illustrative auditor’s report for a cost certification audit engagement is provided at Appendix 8I. Chapter 5 of the HUD audit guide provides guidance for performing cost certification audits.

### **State Housing Agencies, Public Housing Authorities, and Indian Housing Authorities**

107.9 This *Guide* does not cover audits of state housing agencies, public housing authorities, or Indian housing authorities. These entities typically are classified as governmental organizations. Auditors of these entities may use the guidance and practice aids in *PPC’s Guide to Audits of Local Governments* or *PPC’s Guide to Single Audits*.

### **Practice Aids**

107.10 By using the following practice aids, auditors can efficiently conduct an audit of a HUD-assisted entity in accordance with authoritative literature:



- Firm policies (HUD-FP).
  
- Confirmation and correspondence letters (HUD-CL).
  
- Audit programs (HUD-AP).
  
- Checklists and practice aids (HUD-CX).

107.11 PPC practice aids at the HUD-CX section of this *Guide* assist auditors in complying with professional standards and achieve an efficient workflow. At HUD-CX-0.1, the authors have indicated which practice aids should be completed on each engagement to fulfill specific professional standards. Additionally, the authors have indicated which practice aids generally, by themselves, do not fulfill a specific GAAS, Yellow Book, HUD audit guide, and/or Single Audit requirement and which practice aids assist auditors in situations that do not occur on every audit.

107.12 The auditor may choose to document audit procedures in a memo or in another form rather than using a PPC practice aid. To ensure that the alternative documentation meets GAAS, Yellow Book, HUD audit guide and/or Single Audit requirements, the authors recommend that auditors read the practice aid for an indication of the matters to be considered and documented. As a general rule of thumb, the alternative documentation should address the subtitles in the PPC practice aids, thereby indicating how all the major areas for consideration in the practice aid are addressed. Case Study 2 in Appendix B of *PPC's Guide to Audit Risk Assessment* illustrates the PPC audit process using a combination of completed PPC practice aids and memos that replace certain practice aids.

107.13 **Checkpoint Tools** The following electronic practice aids may provide even more efficiency when conducting an audit of a HUD entity:

- *Practice Aids*. *PPC's Practice Aids for HUD Audits*, a companion product to this *Guide*, contains electronic versions of all practice aids included in this *Guide* that can be easily customized for each engagement.
  
- *SMART Practice Aids*.
  - PPC's *SMART Practice Aids—Risk Assessment* interfaces with PPC's *Practice Aids* to help auditors automatically generate tailored audit programs based on their risk assessment for each client engagement.
  
  - PPC's *SMART Practice Aids—Internal Control* integrates with PPC's *SMART Practice Aids—*

*Risk Assessment* to guide auditors through a top-down, risk-based approach for evaluating internal control over financial reporting.

- PPC's *SMART Practice Aids—Disclosure* provides a comprehensive financial statement disclosure preparation and research tool.

- PPC's *SMART Practice Aids—Single Audit* automates the process of determining major programs, “low-risk auditee status,” and appropriate compliance requirements for Single Audits and prepares the compliance audit program and schedule of expenditures of federal awards.

- *Disclosure Libraries*. PPC's *Interactive Disclosure Library for Nonpublic Companies* is an electronic version of a disclosure checklist that provides hundreds of real-world disclosure examples that can easily be pasted into a for-profit entity's financial statements. PPC's *Interactive Disclosure Library for Nonprofit Organizations* is an electronic version of a disclosure checklist tailored for nonprofit entities.

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<sup>9</sup> The *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* supersedes eight OMB Circulars including OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*, effective for audits of fiscal years beginning on or after December 26, 2014. This *Guide* has been updated to reflect the requirements of the new OMB guidance, which is applicable for audits of periods ending on December 31, 2015, or later.

<sup>10</sup> Some HUD-assisted multifamily programs are not included in the Compliance Supplement; however, Part 7 of the Compliance Supplement provides detailed guidance on identifying the compliance requirements and designing compliance tests for programs not included in the Compliance Supplement. See the discussion in section 714.

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