



The New Multifamily Housing Chapter of the HUD Consolidated Audit Guide

GAQC Member Conference Call
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Inspector General

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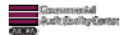


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Agenda

- Reasons for the Chapter 3 Revision
- Changes to Chapter 3
- Sampling (including Group Project Based Sampling)
- Equity Skimming
- Cash Receipts and Disbursements
- Answers to Some Commonly Asked Questions
- Audit Finding Reporting



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Reasons for the Chapter 3 Revision

- Chapter had become outdated – last revision was in December 2001
- Numerous questions & telephone contacts received over the years
- Reviews of audit work
- Problems found in HUD Office of Inspector General (OIG) audits of the Multifamily (MF) entities and are not in audits performed by Independent auditors of the same entity.



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Reasons for the Chapter 3 Revision

- Reviews of Audit Work
 - Insufficient audit coverage
 - Need for increased focus on cash receipts, cash disbursements, and tenant security deposits
 - Evidence of equity skimming & audit failures going undetected
 - Lack of documentation of audit work, including insufficient sampling
 - Canned audit programs used and not complete
 - Stat Sample Project Report for A-133 audits (PCIE report) recommended establishing minimum sampling requirements for audit testing
 - PCIE report showed lowest quality for HUD-specific audits; project specific audits used the old chapter 4 as the project specific audit guide





Reasons for the Chapter 3 Revision

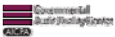
- Problems found in OIG audits of MF entities. Items noted included:
 - Unallowable costs charged to project
 - Many projects operated by same entity but all indirect costs charged to one project
 - Cost distribution not supportable – arbitrary
 - Owner withdrew cash from project – not in “surplus cash” position
 - Surplus cash taken not at end of semiannual or annual fiscal period
 - Funds withdrawn/used by owner and replaced at reporting period





Reasons for the Chapter 3 Revision

- Problems found in OIG audits of MF entities. Items noted included:
 - Disbursements made from Reserve for Replacement Account without HUD Approval
 - Payments not supported by invoices, bills, third party contracts, etc.
 - Funds improperly loaned to related entities
 - Tenants' eligibility not documented in file
 - Variety of problems with tenant file documentation
 - Housing Assistance payments not supported





Reasons for the Chapter 3 Revision

● **Problems found in OIG audits of MF entities. Items noted included:**

- Minimum accounting records not established
- Financial activities of owner commingled in accounting records
- Laundry and other income diverted to owner – not included in project income
- Management fees in excess of HUD-approved amounts paid
- Equity skimming



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Changes to Chapter 3 – Multifamily Housing

● **Effective for audits of profit-motivated sponsors/entities with fiscal years ending on or after December 31, 2008***

*This is a correction from the live audio call.



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Changes to Chapter 3 – Multifamily Housing

- **The old Chapter 4 is now the new Chapter 3**
- **The new Chapter 4 is for audits of HUD-insured hospitals (was made effective upon issuance)**



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Changes to Chapter 3 – Multifamily Housing

- **New Sample Selection Guidance – 3-4, pg 6***
 - Includes Group Project Based Sampling
 - Auditor Judgment
 - Risk Assessment
 - SAS 39, as amended by SAS 111

* All page number references are to Chapter 3, *HUD Multifamily Housing Programs*, of the *HUD Consolidated Audit Guide*, which can be found at:

<http://www.hud.gov/offices/oig/reports/auditguide/ch3.pdf>.





Changes to Chapter 3 – Multifamily Housing

- **Added the following:**
 - Steps for replacement reserve to cover investment of funds - 3-5(D), pg 10
 - Section on equity skimming- 3-5(G), pg 15
 - Section on cash receipts - 3-5(H), pg 15
 - Section on cash disbursements - 3-5(I), pg 19





Changes to Chapter 3 – Multifamily Housing

- **Added the following:**
 - Tenant Application Eligibility and Recertification Audit Steps – 3-5(J), pg 20
 - Added steps for project-based Section 8 assistance- rental to extremely low-income families 3-5(K), pg 23
 - Security deposit section – 3-5(L), pg 24





Changes to Chapter 3 – Multifamily Housing

● Added the following:

➤ Management Function Audit Steps –Section 3-5(M)(2), pg 26-27

- Determine insurance coverage (steps b, c, and d)
- Determine that they respond to HUD reviews, audits, inspections, etc (step e)
- Work order compliance (step f)
- Procedures to assure units meet housing quality standards (step g)
- Management inspection of units (step h)





Changes to Chapter 3 – Multifamily Housing

● Added the following:

- Section for leased nursing homes – 3-5(Q), pg 30
- Section covering Mark-to-Market Program – 3-6, pg 31





Sample Selection (3-4), Pg 6

● Reasons for Inclusion in Guide:

- Puts everyone on the same playing field
- Historically, insufficient work was performed to support the opinion
- Adverse conditions were going undetected
- Audit quality should increase





Sampling - Questions

- A lot of questions were generated on establishing sampling requirements. Questions covered:
 - Group Project Based Sampling (GPBS)
 - Attribute sampling
 - The way the word sampling is used in the guide
 - Utilization of the same sample for many compliance items
 - Scanning - period to be scanned





Group Project Based Sampling

- Eligible compliance areas for Group Project Based Sampling (GPBS), 3-1, pg 1:
 - Tenant Application, Eligibility, and Recertification
 - Tenant Security Deposits
 - Management Functions
 - All other compliance areas tested at the project level
 - These compliance requirements are project specific such as Mortgage status, Replacement reserve, Residual receipts, Distribution to owners, Cash, Financial reporting, Fair Housing and Nondiscrimination....





Group Project Based Sampling

- When Can I use GPBS? 3-1, pg 1
 - You can use group project-based sampling if:
 - Same system used by all projects
 - Same supervisor
 - Same procedures
 - No internal control weaknesses identified
 - Owner agrees to the approach
 - Determination supporting to use GPBS Documented must be included in the auditor's documentation





Group Project Based Sampling

● What do you mean by Same Supervisor?

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





Group Project Based Sampling

● What type of weakness are you referring to and does this mean that I should review Internal Control prior to determining to use GPBS?

- When you start your audit, you can use prior information (prior audits, studies, management reviews) to determine if you should consider GPBS. Then you should do your internal control review to determine if significant deficiencies or material weaknesses exist in the current operation which may change your position on whether to use GPBS.
- Material weakness or significant deficiencies are the weaknesses referred to in this guide.

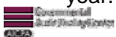




Group Project Based Sampling

● If I know that a project has many problems, can I audit that project as a stand-alone project and not include it GPBS?

- Yes you can treat a project on a standalone basis.
- This project will not be counted as a part of the 20% or minimum sample of 4 for that year.





Group Project Based Sampling

- Does the result have to be included in every report?
 - No, if it is a standalone project audit. 3-8(D), pg 36
 - Yes, if the project was initially selected out of the pool of projects to be considered in the GPBS selection process and the determination was made after the internal control review to make it a standalone project. 3-1, Pg 1
 - The audit documentation has to evidence the process by which it was decided for the project to be audited as a standalone project.





Group Project Based Sampling

- Do I have to use GPBS?
 - No
 - It was developed as a means to limit the amount of testing to be done. You can do your testing on each project if you so desire.
- Reporting under GPBS
 - Findings are reported for all projects in the population 3-1, pg 1
 - Monetary amounts are project specific 3-1, pg 2





Group Project Based Sampling

- Can the GBPS sample selection be used for audit step 3-5K (Units Leased to Extremely Low-Income Families), pg 23?
 - Auditor's judgment is to be used and if the audit objective will be met the GBPS sample can be used. This has to be documented in the audit documentation.
 - If the number in GBPS did not satisfy the minimum sample requirements, additional tenants are to be selected to satisfy the sample size requirement.





Group Project Based Sampling

- Is there anything else I must know if I use GPBS?
 - If the auditor elects to do the five-year sampling plan, the sampling schedule and system for selecting must be included in the work papers so subsequent auditors can ensure that all projects in the population will continue to be audited systematically. 3-1, Pg 2
 - The auditor's opinion for compliance is to be provided for each individual project and the compliance testing must support the opinion for each individual project and not the group as a whole.
 - Minimum coverage of 4 projects per year each project covered at least once every 5 years. 3-1, Pg 2





Sampling - Attribute Sample Size

- Chapter 3 requires Minimum sample size and attribute sampling for any procedure where a sample is to be selected.
- Auditor needs to determine attribute testing sample sizes; the auditor needs to determine the value for three inputs: (Appendix A, pgs 38-40)
 - desired confidence level,
 - tolerable exception rate, and
 - expected exception rate.





Sampling - Attribute Sample Size

- Minimum sample sizes, Appendix A, pg 40
 - Populations of 200 or Fewer Items:
 - Between 100 and 199 = 20 items
 - Between 50 and 99 = 10 items
 - Between 20 and 49 = 5 items
 - Fewer than five items for smaller populations





Sampling – Attribute Sample Size

- Appendix A, pg. 38-40 provides a table on minimum sample sizes based on standard criteria and additional information on attribute sampling
- Audit Documentation must include justification if attribute sampling is not used
- Sample Selection Method:
 - The guide does not address the sample selection method.
 - The auditor is encouraged to follow SAS 39, as amended by SAS 111, in determining the method he/she would want to use.





Commonly Asked Sampling Question

- Do we have to follow the sampling procedures stated in the guide?
 - Yes the following is stated in 3-4, pg 6 and 7:
 - "The attribute sampling method of selecting a sample is to be used anytime in this chapter a statement is made that a sample is to be selected. If the auditor is of the opinion that another sampling method should be used for a particular audit; for example, when the objective is to sample transaction dollar values for purposes of statistically estimating over/understatements (variable sampling methodology), the working papers must contain justification for the methodology used..."
 - "... The sample sizes stated in appendix A are to be the minimum sample sizes to be used regardless of the methodology the auditor uses in lieu of attribute sampling."





Commonly Asked Sampling Question

- Can sample size be reduced based on the results of field reviews? 3-5(J)(2)(c), pg 21
 - No. the intent is:
 - To know the problems that existed.
 - To allow testing of current activity to determine if problems were corrected or still exists.
 - Can be helpful in evaluation of controls.





Other Sampling Considerations in Guide

- Sample of move in and move out tenants
 - One sample is to cover both 3-5(K), pg. 23 and 3-5(L)(e), pg 25
- Audit guide 3-5(M)(2)(f), pg 27, testing of work orders and tenant complaints
- One sample for both and the minimum sample size is to be used.





Other Sampling Considerations in Guide

- Can one sample for verification of waiting list 3-5(J)(2)(d), pg 21 and review of tenant files 3-5(J)(2)(e), pg 21 be the same sample?
 - No
 - The purpose of the waiting list sample is to determine the integrity of how applicants are accepted as tenants into the project and should cover all housing programs offered at that project
 - The purpose of the tenant file sample is to test the requirements of HUD Handbook 4350.3 which is subsidized housing. Therefore, it should be centered around those type tenants.





Other Sampling Considerations in Guide

- Section 3-5(H)(2)(d), pg. 16, requires a selection of the sample from the cash receipts ledger. It states that a sample should be selected of tenant receipts and traced to the tenant records. Are these the same or different samples?
 - The second sample in 3-5(H)(2)(d)(6) is to be drawn from the sample drawn in 3-5(H)(2)(d). A new sample was not intended.
- Do minimum sample sizes apply to audit step 3-5(Q)(2)(d), pg. 31, for Leased Nursing Homes?
 - Yes





Other Sampling Considerations in Guide

- Can the sample selected in 3-5(L)(2)(e), pg. 25 and that selected in 3-5(J)(2)(d), pg. 21 be the same sample?

- The auditor should exercise his/her judgment as to whether or not the objectives of both areas are met through using the same sample. The audit documentation is to contain information in support of the auditor's judgment if the same sample is used.





Equity Skimming - 3-5(G), pg 15

- Equity Skimming Conditions - Appendix B, pg 42

- This information is included to help establish an understanding of equity skimming conditions.
- Equity skimming is the willful misuse of any part of the rent, assets, proceeds, income, or other funds derived from the project covered by the mortgage for any purpose other than to meet actual or necessary expenses of the project.



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Equity Skimming - 3-5(G), pg 15

- Effects of Equity skimming:

- Deprives the project of needed funds for repairs, maintenance, and improvements, which contributes to the financial and physical deterioration of the project and the standard of living conditions for the families who depend on the federal government to provide housing.
- A community where the project is located suffers since the project may become the breeding ground for crime, violence, and drugs.



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Equity Skimming Conditions, Appendix B, pg 42-43

- A review of cash disbursements and/or expense accounts of projects revealed use of project funds to pay for:
 - Maintenance, administrative, or other expenses of the owner, other programs, or other projects.
 - Debts of the owners or management agent.
 - Loans to owners, principals, or affiliate companies.
 - Mortgages and related expenses not related to the project.





Equity Skimming Conditions, Appendix B, pg 42-43

- A review of cash disbursements and/or expense accounts of projects revealed use of project funds to pay for:
 - Personal expenses, such as food, clothing, entertainment of wife and friends, private car expenses, etc., on a project credit card.
 - Individual partner tax preparation or counseling fees (the preparation of the project tax return may be paid from operations).
 - Legal fees for handling disputes among partners.
 - Expenses related to arranging the sale of the project or part of the project.
 - Excessive legal fees.





Equity Skimming Conditions, Appendix B, pg 42-43

- A review of cash disbursements and/or expense accounts of projects revealed use of project funds to pay for:
 - Splitting of fees with the management agent or others who provide services to the project. This can be an illegal kickback whereby a company agrees to refund a portion of its fees to an owner in return for awarding the management or services contract to the company.
 - Theft of funds in which owners or management agents may write checks to themselves or relatives and not try to hide the fact that they have taken the funds.
 - Two contractors paid for the same service





Equity Skimming Conditions, Appendix B, pg 42-43

● A review of cash disbursements and/or expense accounts of projects revealed use of project funds to pay for:

- Expenses to identity-of-interest (IOI) companies when the IOI company:
 - Is a conduit for the purchase of materials and supplies and adds on an excessive percentage mark-up beyond what is needed to cover its own expenses.
 - Paid for labor and materials to repair the project but is using on-site maintenance staff and/or materials to do the work.
 - Is leasing equipment to the project at rates significantly in excess of those charged on the open market.
 - Does not do any work nor was there any evidence that they ever did any work. The IOI may not actually exist, and existing bank account may be used to launder funds.





Equity Skimming Conditions, Appendix B, pg 42-43

● A review of cash disbursements and/or expense accounts of projects revealed use of project funds to pay for:

- Expenses to identity-of-interest (IOI) companies when the IOI company:
 - Charges cost for property and liability insurance for the project is in excess of prices charged on the open market or for coverage that is inadequate to protect HUD's interests.
 - Provides insurance for the property under a blanket policy covering several HUD and non-HUD properties. The owner or management agent may be prorating an excessive amount to the HUD properties and using the excess reimbursement to offset insurance costs for its non-HUD projects or as a means to divert project funds.

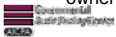




Equity Skimming Conditions, Appendix B, pg 42-43

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

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





Cash Receipts – 3-5(H), pg 15

● Cash Receipts Testing:

- Determine if deposits made accordance with Regulatory agreement and HUD Handbook 4370.2
- Unless centralized account, determine if bank account is in name of project



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Cash Receipts – 3-5(H), pg 15

● Cash Receipts Testing:

- Sample cash receipts to determine:
 - Timely deposit of cash receipts
 - Funds received were properly accounted for and included in the deposit
 - Recorded deposits reconcile to bank statements
 - Deposits posted to correct G/L accounts
 - Cash from other than rental receipts deposited and recorded to correct account(s)
 - Rental receipts amounts trace to tenant lease and A/R record
 - Other adjustments to cash recorded correctly



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Cash Disbursements – 3-5(I), pg 19

● Compliance Requirement

- All disbursements from the regular operating account must be supported by approved invoices, bills, or other supporting documentation. Project funds should only be used to pay for mortgage payments, required deposits to the reserve for replacement fund, reasonable expenses necessary for the operation and maintenance of the project, distributions of surplus cash as permitted, and repayment of owner advances from surplus cash or as authorized by HUD.



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Cash Disbursements – 3-5(I), pg 19

- Select a sample of disbursements from the cash disbursement ledger or similar record and perform the following steps:
 - If made from centralized accounts, were they done in accordance with HUD Handbook 4370.2?
 - Supported by documentation and for the project?
 - Item charge to the correct account(s)?
- Scan disbursements for potential or actual litigation
- Other adjustments to cash recorded correctly
- If balances in excess of FDIC-insured limits determine whether requirements of chapter 2 of HUD Handbook 4370.2 followed.





Commonly Asked Cash Receipt and Disbursement Question

- Audit procedures for testing compliance in cash receipts and disbursements are quite similar to the test of internal controls. Is it possible to combine these tests and achieve both objectives?
 - Yes it is possible. Your audit documentation would have to demonstrate that all the compliance requirements were satisfied.





Commonly Asked Cash Receipts and Disbursements Question

- Can audit step 3-5(D)(2)(f), pg. 11, relating to replacement reserves be met with the results from the cash disbursement or other samples selected or is a separate sample required?
 - A separate sample is required. The objectives of this step would not be met by using another sample drawn for another purpose. The requirement is that a sample of repairs covered by funds from this account be drawn and traced to checks vouchers to determine if funds were used for the purpose authorized by HUD, Replacement Reserve 3-5(D), pg 11.





Commonly Asked Cash Receipts and Disbursements Question

● In 3-5(D)(2)(f), pg 11, what is the definition of the sampling unit? Is it the repair invoice or a disbursement since some disbursements can cover several invoices?

➤ It is important that the auditor uses his/her judgment based on the conditions at the particular auditee, which could be different. The auditor is to determine which will satisfy the audit objective that the amounts paid and billed are proper, supportable, and used for the purpose approved by HUD.





Other Commonly Asked Questions

● For fair housing and nondiscrimination, 3-5(B), pg 8, does the auditor have to follow minimum sample size in place of the review or would a legal letter be sufficient?

➤ A legal letter would not be sufficient and the amount of review should be based on the auditor's risk assessment and the results of other audit procedures.





Other Commonly Asked Questions

● Leased Nursing Homes - 3-5(Q), pg 30

- Are auditors required to visit the property?
 - The statement that a visual inspection should be made is a reminder to the auditor that this is the most reliable method to see the condition of the property and if repairs and maintenance is completed. Also that the property is in a clean, safe, and sanitary condition.
 - The auditor should exercise his/her judgment as to the need for making a visual inspection.





Other Commonly Asked Questions

- In a few areas there are steps stating that the auditor is to scan
 - (1) Journal vouchers for unexplained decreases in accounts payable, notes payable, and related interest to owners or related parties;
 - (2) the Cash Disbursement register to determine if payments were made to owners or related parties;
 - (3) Bank statements for deposits from owners or related parties representing a redeposit of funds for excessive payments or distributions or loans. The question asked is what period of time should be scanned? The entire year, a month, etc.?
 - The purpose of this test is to determine if activity occurred in cash that may not have been recorded in the books-of-account. The auditor should consider the entity's internal control, the risk assessment, and any problems noted in his/her review to that point in selecting the period to be scanned.





Other Commonly Asked Questions

- Do all compliance procedures have to be followed?
 - The introduction in section 3-5, pg. 7, states "The following sections contain suggested audit procedures that HUD believes should be performed. If an auditor determines that the stated procedures to be inappropriate and/or other audit procedures should be performed, the deviation from the stated procedures must be justified and documented in the auditor's working papers."





Use of Guide for A-133 Audits

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





Audit Finding Reporting, 3-8, pg 35

- What is to be reported as a finding in the audit report?
 - All instances of conditions contained in Appendix B, pg 42, on equity skimming
 - Material noncompliance with any HUD requirement or regulations which result in material questioned or disallowed cost; and/or
 - Deficiencies in internal control, fraud, illegal acts, or contract violations that were disclosed during audit process.
 - Noncompliance, deficiencies, or violations that were corrected before the issuance of the audit report must be included in the report as a finding (or in a management letter or other written communication depending on their materiality)



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Audit Finding Reporting, 3-8, pg 35

- What about nonmaterial instances of noncompliance disclosed during the audit?
 - Must be reported separately to management
 - Must be in writing in a management letter or other type of written communication
 - The form and date of this communication must be mentioned in the auditor's report



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Audit Finding Reporting, 3-8, pg 35

- Content of finding
 - Yellow Book Requirements apply
 - HUD Guide Chapter 2 (a revision to this chapter is currently under development)





Audit Finding Reporting, 3-8, pg 35

- What about when management's corrective action not started or in process?
 - Should be developed and reported as a finding with all required elements
 - Auditee can include a description of:
 - Action taken or the action remaining to be taken in the auditee response to the finding in the auditee's comment section of the finding and in the corrective action plan





Audit Finding Reporting, 3-8, pg 35

- What about when management has completed its corrective action?
 - Should be developed and reported as a finding with all required elements
 - Auditee can include a description of:
 - The action taken should be included in the auditee's comment section of the finding and in the corrective action plan
 - Action taken validated by the auditor
 - The auditor's recommendation in the finding should state if the auditor validated or not
 - Auditor can add additional recommendations as needed





The End!