

## **CHAPTER 5. INSURED DEVELOPMENT COST CERTIFICATION AUDIT GUIDANCE**

5-1 Program Objectives. Multifamily insured loans are an integral part of HUD's housing program which has the objectives of providing decent, safe, affordable and sanitary housing for low and moderate-income families.

Through the insured multifamily project loan program, HUD insures mortgage repayments, thereby reducing investor risk and encouraging the availability of a money supply for the housing market. For the insured loan program, the project is ordinarily HUD's only source for loss recovery in the event of a foreclosure. Therefore, it is essential that collateral value is commensurate with the insurance risk.

5-2 Program Procedures. The cost certification is the basis for HUD's determination of the maximum insurable mortgage which is necessary before the project may proceed to final endorsement, a critical factor to multifamily projects. Effective dates for the determination of actual costs are usually the date of the final project inspection report showing final completion and the mortgagor's cost certification cut-off date. The HUD Field Office Manager has the option to set an earlier date to halt the unnecessary accumulation of certain costs. A reasonable time is set for submission of the cost certification which must be in the Field Office 30 days before final endorsement/closing.

HUD expects completed certifications, fully documented and in the prescribed format to be submitted by the mortgagor. If an identity of interest exists between the mortgagor and the contractor, or if a cost plus type construction contract was used, the contractor is also required to submit a cost certification. Similarly, if an identity of interest exists between a subcontractor, materials supplier, or an equipment lessor, then a cost certification must be submitted. Additional support for any cost items questioned by HUD is expected within 15 days of the request. Extended delays in the cost certification process which postpone final endorsement can cause substantial harm to the project's viability and eventual success.

5-3 Reference Material. The IA should obtain and become familiar with the following HUD Handbooks. If not available from the owner, they may be obtained from the local HUD Field Office.

HUD Handbook No.	Title
4470.2	Cost Certification Guide for Mortgagors and Contractors of HUD-Insured Multifamily Projects
4571.1	REV-2 Section 202 Direct Loan Program for Housing for the Elderly and/or Handicapped
4571.5	Supportive Housing for Elderly - Conditional Commitment - Final Closing
4470.1	REV-2 Mortgage Credit Analysis For Project Mortgage Insurance (Section 207)
4450.1	REV-1 Cost Estimation For Project Mortgage Insurance

5-4 Reporting Requirements.

The Mortgagor's Certificate of Actual Cost (Form HUD-92330) in a form prescribed by HUD shall be submitted after the cost Certification cut-off date. Form HUD-92330 is submitted upon completion of the physical improvements to the satisfaction of HUD and before endorsement. The certificate shall show the actual cost to the mortgagor after deduction of any kickbacks, rebates, trade discounts or other similar payments to the mortgagor, or officers, stockholders, or partners.

24 CFR 207.27, 885.425 and 885.825 require mortgagors/borrowers to submit Certificates of Actual Cost before final endorsement of the insured loans or disbursement of loan proceeds or capital advances for the project. Mortgagors and contractors are required to determine costs in accordance with HUD Handbook 4470.1 REV-2, Mortgage Credit Analysis for Project Mortgage

Insurance, and with the Cost Certification Guide for Mortgagor and Contractors of HUD-Insured Multifamily Projects—HUD Handbook 4470.2 . HUD Handbook 4470.2 contains the requirement for who among the mortgagor, general contractor, subcontractors, and suppliers must provide cost certifications and guidance on eligible costs, necessary financial statements which must accompany the Certificate of Actual Cost, and details concerning the Form HUD-92330 (mortgagor) and Form HUD-92330-A (contractor).

Each Form HUD-92330 and Form HUD-92330-A must be accompanied by the auditor's report on the certification of actual cost. The IA is also required to report on the accompanying balance sheet and operating statement, the consideration of the mortgagor's internal control structure and the mortgagor's compliance with specific requirements. The period covered by the operating statement is from the beginning of marketing and rent-up activities to the cut-off date. The Form HUD-92330 should be supported by the information contained in the required financial statements.

The Certificate of Actual Cost, auditor's reports and required financial statements should be submitted to the applicable HUD Field Office. An illustrative report on cost certification is provided in the final section of this Chapter.

For cost certifications due from contractors (HUD-92330-A), the auditor need only submit the Contractor's Certificate of Actual Cost and his/her report thereon. No other financial statements or reports are necessary, nor is this Certificate subject to an audit in accordance with the Government Auditing Standards.

#### 5-5 Compliance Requirements and Audit Area

##### A. Federal Financial Reports .

1. Compliance Requirement. Projects participating in HUD-assisted activities are required to ensure that financial status reports contain reliable financial data and are presented in accordance with the terms of applicable agreements between the entity and HUD. The individual agreements contain the specific reporting requirements that the entity is to follow.

##### 2. Suggested Audit Procedures

a. Identify all required financial reports by inquiry of the owner/manager.

b. Obtain an understanding of the auditee's procedures for preparing and reviewing the financial reports.

c. Select a sample of financial reports, other than those which are included in the audited financial statements, and determine that the reports selected are prepared in accordance with HUD instructions.

d. For the sample, trace significant data to supporting documentation, i.e. worksheets, ledgers, etc. Report all material differences between financial reports and project records.

e. Review significant adjustments made to the general ledger accounts affecting HUD-assisted activity and evaluate for propriety.

##### B. Accounting System .

1. Compliance Requirement. Mortgagors and contractors involved in projects that are to receive HUD-insured loans have agreed to maintain adequate records for the purpose of determining the eligible costs associated with the projects (HUD Handbook 4470.2 , Chapter 3).

##### 2. Suggested Audit Procedures

- a. Obtain an understanding of the mortgagor's and contractors, accounting system for identifying actual costs associated with a given project. Test the system to determine that it identifies the costs to be reported on the Form HUD-92330 on an individual project basis.
- b. Review Form HUD-92330 for completeness and support by the accounting records.
- c. Trace significant data from Form HUD-92330 to supporting documentation, ie. worksheets, ledgers, etc. Report all material differences between the amounts reported on the Form HUD-92330 and the supporting documents.

#### C. Cut-Off Timing and Eligibility of Costs

1. Compliance Requirement. As a general rule, only the costs which have been or will be paid in cash within 45 days after the date of final endorsement or closing, or which are escrowed with the mortgagee are eligible for inclusion on the mortgagor's or contractor's Certificates of Actual Cost.

For projects with insured mortgages, the mortgagor determines the cost cut-off date for the actual cost of interest, taxes, and mortgage insurance premium. This date may, at the earliest, be the same date as the final completion date, and at the latest, be a date 60 days after the final completion date or at the mortgagor's option, any date in between. - The date chosen as the cut-off date and the date to which the operating statement and balance sheet are computed must be the same.

The final completion date is the date on which the HUD representative signs the final HUD Representative's Trip Report, Form HUD-5379, showing substantial completion. This form must be properly endorsed by the Field Chief Architect.

HUD notifies the mortgagor/borrower, the general contractor and the mortgagee of the date of completion in writing. This date becomes the basis for establishing the cut-off date for insured projects, direct loan projects and capital advance projects (HUD Handbook 4470.2, Chapter 1). Eligible costs are those costs of the project construction and certain fees actually paid in cash or such costs that will be paid in cash within 45 days of final endorsement. HUD Handbooks 4470.1 REV-2, 4450.1 REV and 4470.2, Chapter 2, contain information on allowable costs to be reported on Form HUD-92330 and the ways in which costs are to be adjusted for items considered to be a recovery of costs.

#### 2. Suggested Audit Procedures

- a. Review the trip report Form HUD-5379 or similar notification to determine the final completion date.
- b. Based on the completion date, the mortgagor/borrower determines the project's cut-off date for time sensitive expenses, such as interest, taxes and mortgage and property insurance premiums. Review these cost/charges to determine that none were incurred after the cut-off date.
- c. Review the other amounts claimed on Form HUD-92330 to determine that the claims represent

those expenses paid in cash or expected to be paid in cash within 45 days after final closing. All amounts claimed should be net of any adjustments or recoveries of costs.

D. Identity of Interest

1. Compliance Requirement. HUD Handbooks 4430.1 REV-1, 4470.1 REV-2 and 4470.2, Chapter 3, describe several situations which constitute an identity of interest involving a mortgagor, a contractor, a subcontractor, or a materials supplier. Where an identity of interest exists the contractor must also submit a Certificate of Actual Cost or the party involved in the identity of interest is required to submit additional documentation as required by 4470.2 Chapter 3. The contractor is also required to submit a Certificate of Actual Cost if a cost plus construction contract was used.

2. Suggested Audit Procedures

a. Review mortgagor and project records such as contracts and vendor invoices to determine if an identity of interest exists between any of the parties involved in the project, from mortgagors to contractors, suppliers and equipment lessors.

b. Where an identity of interest exists, determine that the additional reporting requirements of HUD Handbook 4470.2 have been met.

5-6 Illustrative Report

Report of Independent Certified Public Accountants

To the Partners

Sample Company

We have audited the Mortgagor's Certificate of Actual Costs Form HUD-92330), through April 30, 1997, pertaining to the development of the Sample Company, Project No. xxx-xxxxx, the statement of assets, liabilities and project equity, as of April 30, 1997 and the results of project operations for the period from August 28, 1995 (date of commencement of marketing and rent-up activities, etc.) through April 30, 1997. These financial statements are the responsibility of the Partnership's Management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the Certificate of Actual Cost and the Project's financial statements have been prepared on the basis of accounting and reporting practices prescribed by the Department of Housing and Urban Development (HUD). These prescribed practices are a comprehensive basis of accounting other than generally accepted accounting principles. Furthermore, the accompanying financial statements represent the financial statements of the project. This report is intended solely for filing with HUD and is not intended for any other purpose.

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In our opinion, the Mortgagor's Certificate of Actual Cost and the financial statements referred to above, present fairly the actual costs of the Sample Company, through April 30, 1997, the assets, liabilities and project equity, as of April 30, 1997, and the results of project operations for the period from August 28, 1995 (date of commencement of marketing and rent-up activities, etc.) through April 30, 1997, on the basis of accounting described in Note 1. In accordance with Government Auditing Standards we have also issued a report dated [date of report] on our consideration of [the Entity's] internal controls and a report dated [date of report] on its compliance with laws and regulations.

Certified Public Accountant  
[date of audit]

SAMPLE COMPANY  
PROJECT NO. XXX-XXXXX  
NOTES TO FINANCIAL STATEMENTS

1 --- Summary of Significant Accounting Policies  
Basis of Presentation

The financial statements have been prepared in conformity with the accounting and reporting standards prescribed by the U.S. Department of Housing and Urban Development (HUD) in the Audit Guide for Auditing Development Costs of HUD-Insured Multifamily Projects. These standards differ in some respects from generally accepted accounting principles, and the financial statements reflect the following additional HUD accounting and reporting principles:

- a. Costs are to be exclusive of kickbacks, rebates or trade discounts.
- b. Financing charges are limited to the lesser of amounts actually paid, or amounts approved by HUD, on the Mortgagee's Certificate. For this project, the financing charges are the amounts actually paid.
- c. The statement of rental operations reflects the rental activity and operating expenses of the Project from August 28, 1995. The statement does not include depreciation and amortization expenses and certain

other expenses which are not incidental to the rental operation of the Project.

d. Project equity represents the difference between the funds received by the Project from Sample Company, and the costs incurred to develop the Project, and the income from the Project. Furthermore, Partnership (non-project) obligations are classified as project equity. Accordingly, Project equity is not intended to reflect the equity of the Partnership and the financial statements are not intended to represent those of the Partnership.

SAMPLE COMPANY  
PROJECT NO. XXX-XXXXX  
NOTES TO FINANCIAL STATEMENTS

1 --- Summary of Significant Accounting Policies  
Organization

Sample Company is a limited partnership organized under the laws of the State of [State of Project], for the purpose of developing and operating the Sample Company, a 203-unit project located in [location of Project]. The Partnership will operate under the provisions of Section 221(d)(4) of the National Housing Act, with mortgage insurance provided by the Federal Housing Administration (FHA) of the Department of Housing and Urban Development. The responsibility for management of the affairs of the Partnership, and the ongoing management of the Sample Company is vested with the general partners. Compensation for such services is as determined in the management agreement between the partners.