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## CHAPTER 5. DEVELOPMENT COST CERTIFICATION AUDIT GUIDANCE

**5-1 Program Objective.** Multifamily projects are an integral part of the U.S. Department of Housing and Urban Development's (HUD) housing programs, which have the objectives of providing decent, safe, affordable, and sanitary housing for low- and moderate-income families. \*The loans for the multifamily projects are insured through the multifamily project loan program. \*HUD- Federal Housing Administration (FHA) insures lenders against losses on mortgages providing the financing for the construction or rehabilitation of multifamily rental projects. 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 be commensurate with the insurance risk.

\*This handbook chapter is intended for use by for-profit mortgagors to provide audit guidance for the audit of development cost certifications. However, this chapter can also be used to provide audit guidance to not-for-profit mortgagors for their audits of development cost certifications as provided for under OMB Circular A-133, paragraph 235(a), program-specific audit guide available.\*

**5-2 Program Procedures.** \*The cost certification is the basis for HUD's determination of the project's actual development cost and/or the maximum insurable mortgage, which is necessary before the project may proceed to final formal endorsement, a critical factor to multifamily projects. The effective date for the determination of actual costs is usually the date the HUD inspector signs the final HUD representative's trip report (Form HUD-95379), provided that the trip report is subsequently endorsed by the construction manager. Construction must be completed, except for acceptable items of delayed completion (Multifamily Accelerated Processing Guide (MAP Guide), chapter 14, section 14.7). 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 HUD field office 30 days before final endorsement/closing. Typically, the cost certification is prepared and submitted within 60 to 90 days after the cost cutoff date. The cost certification is submitted in hard-copy format to the HUD field office. The cost certification is **not submitted electronically** to HUD's Real Estate Assessment Center (REAC).

The owner's first operating audit will cover the period beginning on the day after the cost certification cutoff through the owner's fiscal year end. All operating audits must be prepared in accordance with chapter 3, HUD Multifamily Housing Programs, of this guide and must be submitted to REAC electronically via the Financial Assessment Subsystem (FASS) within 90 days of the owner's fiscal year end.\*

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\*On occasion, the owner may be responsible for submitting financial statements with reporting periods of less than 12 months (referred to as a stub period). If that reporting period is less than 90 days, upon request, HUD may approve the deferment of the owner's reporting of the stub period and add that period to the next full year financial statements (Submission and Review Requirements & REMS Critical Data Fields for Annual Financial Statements, attachment 2, paragraph C).\*

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 equipment lessor, 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.** \*One of the primary sources of guidance for cost certifications is the MAP Guide. In particular, chapter 14 contains the most current guidance issued by HUD regarding the cost certification process. The following is the reference material that was in effect at the time this handbook chapter was issued. It is the auditor's responsibility to use the appropriate reference material that was in effect during the period covered by the audit.

Throughout this chapter, reference is made to handbooks using the base handbook number without the revision number (i.e., REV-1, REV-6, etc.). This will enable periodic updates to paragraph 5-3 rather than revising the references in the entire handbook/chapter. Also, the auditor should ensure that the updated reference is used for performing the audit. If reference to the handbook is needed in the audit report, the auditor should ensure that the entire updated reference, including the revision number, is used.\*

<b>Document</b>	<b>Title</b>
HUD Handbook 4571.5	Supportive Housing for Elderly, Conditional Commitment - Final Closing
*HUD Handbook 4571.4	Supportive Housing for Persons with Disabilities, Conditional Commitment - Final Closing*
HUD Handbook 4571.1, REV-2	Section 202 Direct Loan Program for Housing for the Elderly and/or Handicapped

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<b>Document</b>	<b>Title</b>
HUD Handbook 4470.2, REV-1	Cost Certification Guide for Mortgagors and Contractors of HUD-Insured and Section 202/811 Multifamily Projects
HUD Handbook 4470.1, REV-2	Mortgage Credit Analysis for Project Mortgage Insurance, Section 207
HUD Handbook 4450.1, REV-1	Cost Estimation for Project Mortgage Insurance
*HUD Handbook 4435.1, REV-1	Project Construction and Servicing Before Final Closing*
*Notice H 96-102	Redesigned Section 202 Supportive Housing for the Elderly and Section 811 Supportive Housing for Persons with Disabilities Programs - Firm Commitment*
*Mortgagee Letter 04-41	Multifamily Accelerated Processing Guide Revised March 15, 2002 (1)*
*Document does not have a HUD number or transmittal reference	Submission and Review Requirements & REMS Critical Data Fields for Annual Financial Statements (2)*

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(1) = This document is not a numbered document under the HUD unified issuance system and can be obtained by using the following link:

<http://www.hud.gov/offices/hsg/mfh/map/mapguide/mapguide.cfm>

(2) = This document is not a numbered document under the HUD unified issuance system and can be obtained by using the following link:

[http://www.hud.gov/offices/reac/products/PDFs/finl\\_memo\\_2004\\_1a.pdf](http://www.hud.gov/offices/reac/products/PDFs/finl_memo_2004_1a.pdf)

If the program participant does not have this reference material, it may be obtained by accessing HUD's Client Information and Policy System (HUDCLIPS) at the following Web site:

<http://www.hudclips.org/cgi/index.cgi>

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\*or may be ordered from HUD's Direct Distribution System by telephone at (800) 767-7468; in a letter addressed to HUD, Customer Service Center, Room B-100, 451 Seventh Street, SW, Washington, DC 20410; or by fax at (202) 708-2313.

#### **5-4 Reporting Requirements.**

Regulations at 24 CFR [*Code of Federal Regulations*] 200.95, 200.96, 200.97, and 891.545 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 Mortgage Credit Analysis for Project Mortgage Insurance, HUD Handbook 4470.1; Cost Certification Guide for Mortgagors and Contractors of HUD-Insured Multifamily Projects, HUD Handbook 4470.2; Chapter 5, Supportive Housing for Persons with Disabilities, Conditional Commitment - Final Closing, HUD Handbook 4571.4; Chapter 5, Supportive Housing for Elderly - Conditional Commitment Final Closing, HUD Handbook 4571.5; Section VI of HUD Notice H 96-102; and chapter 14 of the MAP Guide. The MAP Guide, as well as HUD Handbook 4470.2, contains the requirement for who among the mortgagor, general contractor, subcontractors, and suppliers must provide cost certifications, guidance on eligible costs, necessary financial statements which must accompany the certificate of actual cost, and details concerning the mortgagor's Form HUD-92330 and contractor's Form HUD-92330-A.

Mortgagors and contractors must prepare certification of actual cost and submit the required financial statements. The mortgagor's certificate of actual cost (Form HUD-92330) shall be submitted after the cost certification cutoff date. It 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. Those documents must be prepared in conformity with the basis of accounting and reporting procedures prescribed by HUD, which is a comprehensive basis of accounting other than generally accepted accounting principles. The owner must sign and date Form HUD-92330, and the contractor must sign and date Form HUD-92330-A, in the areas provided on the forms, by no later than the date of the audit opinion.

**A. Mortgagor Submission Requirements.** Mortgagors must certify for all projects except 207/223(f) refinances in which the insured value is 80 percent or less of value. They are to submit the mortgagor's cost certification (Form HUD-92330) supported by an accountant's opinion, an audited balance sheet of the mortgage entity as of the cutoff date, and an audited operating statement if occupancy\*

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\*occurred before the cost certification cutoff date. An audit report with the certification by an independent certified public accountant or an independent public accountant must accompany the mortgagor's certification of actual cost, the audited balance sheet and operating statement of the mortgagor, and the contractor's certificate of actual cost (Form HUD-92330A). The period covered by the operating statement is from the beginning of marketing and rent-up activities to the cutoff date. Costs reported on Form HUD-92330 support certain entries on the required financial statements. If there were more than three months between the cost cutoff date and the start of amortization, the mortgagor must submit a supplemental operating statement.

The certificate of actual cost, auditor's reports, and required financial statements are to be submitted to the applicable HUD field office.

The auditor must conduct the audit under both the auditing standards generally accepted in the United States of America and the generally accepted government auditing standards (GAGAS) issued by the comptroller general of the United States (MAP Guide chapter 14, section 14.11, paragraph 6 and chapter 2 of this guide). Illustrative reporting information on the cost certification is provided in paragraph 5-7 of this chapter.

**B. Contractor Submission Requirements:** Contractors must certify when

- (1) The contractor has an identity of interest with the mortgagor and/or
- (2) The contractor used the Construction Contract Cost Plus, Form HUD-92442-A.

A subcontractor at any tier, equipment lessor, material supplier, and manufacturer of industrialized housing must certify when

- (3) The total of all subcontracts, purchases, and leases is more than .5 percent of the mortgage and
- (4) An identity of interest exists or comes into being between such subcontractor, equipment lessor, material supplier, or manufacturer of industrialized housing and either the mortgagor or the contractor if the contractor must certify.

The contractor is to submit a certificate of actual cost (Form HUD-92330A), supported by an accountant's opinion, to the mortgagor. A certification by an independent certified public accountant or an independent public accountant must\*

\*accompany the contractor's certification of actual cost. The auditor must use GAGAS in auditing the cost certification. No other financial statements or reports of the contractor are required to be submitted. The contractor should submit the reporting package to the mortgagor for inclusion in the mortgagor's submission to the appropriate HUD field office.\*

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

### **A. Federal Financial Reports.**

- 1. Compliance Requirement.** Projects with a HUD - insured mortgage or receiving HUD direct loans or capital advances 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 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 and capital advances have agreed to maintain adequate records for the purpose of determining the eligible costs associated with the projects (HUD Handbook 4470.2, chapter 3).

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## 2. Suggested Audit Procedures.

- a. Obtain an understanding of the mortgagor's and contractor's accounting system for identifying actual costs associated with a given project. Test the system to determine whether 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; i.e., worksheets, ledgers, etc. Report all material differences between the amounts reported on the Form HUD-92330 and the supporting documents.

## C. Cutoff 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 cutoff date for the actual cost of the interest, taxes, insurance, and mortgage insurance premium as well as soft costs and special escrow items. 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 cutoff date and the date to which the operating statement and balance sheet are computed must be the same. \*The mortgagor, general contractor, and mortgagee will be notified in writing of the final completion date (MAP Guide chapter 14, section 14.7).\*

The final completion date is the date on which the HUD inspector signs the final HUD Representative's Trip Report, Form HUD-95379, showing substantial completion. The field construction manager must properly endorse this form.

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 cutoff date for insured projects, direct loan projects, and capital advance projects (HUD Handbook 4470.2, chapter 1, \*and MAP Guide, chapter 14)\*.

Eligible costs are those costs of the project construction and certain fees paid in cash or such costs that will be paid in cash within 45 days of final endorsement. HUD Handbooks 4470.1; 4450.1; 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-95379, or similar notification to determine the final completion date.
- b. Based on the completion date, the mortgagor/borrower determines the project's cutoff date for time-sensitive expenses, such as interest, taxes, insurance, mortgage, and property insurance premiums, as well as soft costs and special escrow items. Review these costs/charges to determine that none were incurred after the cutoff date \*and that the costs are proper charges to the project.\*
- 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 on behalf of the project. All amounts claimed should be net of any adjustments or recoveries of costs.

**D. Identity of Interest.**

1. **Compliance Requirement.** HUD Handbooks 4430.1; 4470.1; 4470.2, chapter 3; and MAP Guide, chapter 14, Section 14.15, describe several situations, which constitute an identity of interest involving a mortgagor, a contractor, a subcontractor, or a materials supplier. When 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 HUD Handbook 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 whether an identity of interest exists among any of the parties involved in the project, from mortgagors to contractors, suppliers, and equipment lessors. \*Inquire to determine whether an identity-of-interest relationship exists.\*

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- b. When an identity of interest exists, determine that the additional reporting requirements of HUD Handbook 4470.2 and MAP Guide, chapter 14, have been met.

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## **5-6 Audit Finding Reporting.**

All material instances of noncompliance with any HUD requirement or regulation, deficiencies in internal control, fraud or illegal acts, or contract violations that were disclosed during the audit process must be reported as findings in the audit report. All nonmaterial instances of noncompliance, deficiencies in internal control, fraud or illegal acts, or contract violations disclosed during the audit process may be reported separately to management. Such reporting must be in writing in a management letter or other type of written auditor communication and must be mentioned in the independent auditor's report, including the date of the management letter or other written communication. Noncompliance's, deficiencies, or instances of violations that were corrected during the audit process, after the fiscal year under audit, or disclosed as a part of the audit process before the end of the fiscal year under audit and/or before the issuance of the audit report must be included in the report as resolved findings or in a management letter or other types of written auditor communication, depending on their materiality.

### **A. Content of Finding.**

Findings are to be presented in accordance with the standards and requirements of the "Yellow Book." A finding should be supported by sufficient, competent, and relevant evidence; be presented in a manner to promote adequate understanding of the matters reported; and provide convincing but fair presentations in proper perspective.

Please refer to chapter 2 for the information that is to be included in a finding.

### **B. Corrective Action in Process.**

Many times when auditees are presented with draft findings, they will start to take action to correct the deficient condition. When this action is underway and the auditor has completed his/her fieldwork, the auditee can include the action completed and the action remaining to be taken in the auditee's comments and in the corrective action plan. Regardless of whether the auditee is in the process of correcting the finding, the auditor is to include the finding in the report with all required elements.\*

**C. \*Corrective Action Completed.**

Many times when auditees are presented with draft findings, they will start to take action and complete that action, correcting the deficient condition before the completion of the fieldwork. When this occurs, the finding is still to be included in the audit report with all required elements. The action taken/completed should be included in the auditee's comment section and should be validated by the auditor. The recommendation section should follow the auditee's comment section, and the auditor should state whether he/she validated the action or not. In addition, the auditor could include any additional recommendations he/she believes necessary based on their validation of that action.

If costs are involved and if those costs have been repaid, the auditor should validate that the auditee made the necessary adjustments to its books-of-account. The auditor's certified statements should contain all necessary adjustments to the reported amounts, with appropriate notes, so that the certified costs of the project are accurately stated. Comments should also be included in the report in the "action taken" section of the finding. \*

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- 5-7 Illustrative Reporting.** \*These samples are for the *Sample Company*, which is a partnership. The wording is to be changed based on the type of ownership of the property.\*

## 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 [insert cutoff date, for example, April 30, 2010]; pertaining to the development of the *Sample Company*, Project No. [Insert project number]. We have also audited the [insert names of statements included in the report (financial statement)] as of [insert the cutoff date, for example, April 30, 2010], and the results of project operations for the period from [insert date, for example, August 28, 2008, which is the date of commencement of marketing and rent-up activities, etc.] through [insert the cutoff date, for example, April 30, 2010]. The Form HUD-92330 and the financial statements are the responsibility of the *Sample Company's* management. Our responsibility is to express an opinion on the Form HUD-92330 and on the financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the government auditing standards issued by the comptroller general of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Form HUD-92330 and the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the Form HUD-92330 and 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 [insert the note number], the certificate of actual cost (Form HUD-92330) and the project's financial statements were prepared in conformity with the basis of accounting and reporting practices prescribed by the U.S. Department of Housing and Urban Development (HUD), which is a comprehensive basis of

accounting other than generally accepted accounting principles. Further, the accompanying financial statements represent the financial statements of the project.

In our opinion, the mortgagor's certificate of actual costs (Form HUD-92330) and the financial statements referred to above present fairly, in all material respects, the actual costs of the *Sample Company*, through [insert cutoff date, for example, April 30, 2010]; the assets, liabilities, and project equity as of [insert cutoff date, for example, April 30, 2010]; and the results of project operations for the period from [insert date, for example August 28, 2008, which is the date of commencement of marketing and rent-up activities, etc.] through [insert cutoff date, for example, April 30, 2010], on the basis of accounting described in note [insert the note number].

In accordance with government auditing standards, we have also issued our report dated [date of report] on our consideration of the *Sample Company's* internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with government auditing standards and should be considered in assessing the results of our audit.

This report is intended solely for the information and use of the board of directors and management of the *Sample Company* and HUD and is not intended to be and should not be used by anyone else other than these specified parties.

Certified Public Accountant Signature

Date

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*Sample Company*  
Project No. XXX-XXXXX

**Notes to Financial Statements**

**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 [insert comment that applies - actually paid or approved by HUD].
- c. The (insert actual name of statement; i.e., statement of rental operations) reflects the rental activity and operating expenses of the project beginning [insert date of commencement of marketing and rent-up activities, etc., for example, August 28, 2008]. 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, plus the income from the project. More detailed information on the determination of equity is contained in the MAP Guide, chapters 7, 12, and 14. Further, partners' (members') (nonproject) obligations are classified as project equity. Partners' (members') equity is not intended to reflect the actual equity of the partnership because it may include partnership obligations and adjustments for the as-is value of land. The financial statements are not intended to represent those of the partnership.

*Sample Company*  
Project No. XXX-XXXXX

Notes to Financial Statements

**Summary of Significant Accounting Policies**

**Organization**

*Sample Company* is a limited partnership organized under the laws of the state of [Insert name of State], for the purpose of developing and operating 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 U.S. 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.

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**5-8 Technical Assistance Needed.**

The chief, Technical Support Division, Office of Multifamily Housing Development, is responsible for answering programmatic questions for the programs being audited using the procedures outlined in this chapter. Programmatic questions on audits performed using this chapter should be referred to that office, 202-708-0614, extension 2559.\*